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Amber Waves of Pain

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Do Not Buy Commodity ETFs

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Feedback

The Gates Effect

● Regarding "Teachers' Pest" (Features, July 19-July 25): In New York City, we have made phasing out large, underperforming schools and replacing them with smaller, mission-driven schools a central piece of our reform agenda.

A rigorous and comprehensive study recently released by the independent research group MDRC shows that students in our new small schools were more likely to be on track to graduation in their first year of high school, and to stay on track, compared with students in other high schools. The study also showed that our small schools are working particularly well for students from traditionally disadvantaged groups, including black and Hispanic students, special education students, students learning English, and students entering high school with low performance levels. This progress came in no small part thanks to the crucial funding and support the Bill & Melinda Gates Foundation provided.

Joel I. Klein
Chancellor
New York City Department of Education

No Way to Retire

● I was appalled by the arrogance of Teresa Ghilarducci ("I'll Say It Again: Dump the 401(k)," Focus on Retirement, July 19-July 25). Her piece is basically advocating another brand of Obama socialism. Who in their right mind would want to enroll in a retirement plan whose income comes from the soon-to-be-worthless U.S. Treasury bonds?

Justin P. Yagoobian
Beverly Hills, Calif.

Washington and the Big Spill

● In response to "The Lost Summer" (Features, July 12-July 18): BP was committed to making people whole until Interior Secretary Kenneth Salazar put his boot on their neck, Obama went searching for an ass to kick, and Attorney General Eric Holder threatened their executives with jail. With the best intentions ignored and smashed, any incentive to do what is right has been killed. And that message has been telegraphed to thousands of other CEOs.

Ed Gabrielse
St. Charles, Ill.

Reviving U.S. Employment

● The article by Andy Grove, "How to Make an American Job" (Features, July 5-July 11), was excellent. One major factor in pushing jobs overseas is that we have some of the highest corporate tax rates in the world. Many developing countries eager for jobs and knowhow are offering much lower rates that are often effectively zero. If anything, corporate taxes should be done away with. Just as all companies are ultimately owned by individuals, all company taxes are ultimately paid by individuals. Let the individual tax code be the primary way to collect and redistribute income, and we will do a much better job retaining our golden geese.

Chris Waldorf
Seattle

● Grove's analysis of what it takes to create a tech job was trenchant. But putting all the other details aside, costs drive decisions regarding where commoditized products are made. If America wants manufacturing jobs, either high-tech or low, removing impediments to productivity is what's needed. An example of what happens when productivity gets too low is the nearly complete loss of agricultural jobs in my own state in recent decades. Lanai, nicknamed the Pineapple Isle, grows no pineapples anymore: The high cost of unionized farm labor in Hawaii coupled with the union-protectionist Jones Act (making shipping costs prohibitive) ended large-scale farming on Lanai and nearly everywhere else in Hawaii.

Michael P. Rethman
Kaneohe, Hawaii

The Peterson Crusade Refined

● "Spending Big to Stop Big Spending" (Politics&Policy, July 5-July 11) incorrectly implies that Pete Peterson opposes the potential extension of unemployment benefits. The Peter G. Peterson Foundation does not endorse or oppose specific legislation, although we do believe that unemployment insurance is critically important for American families especially during a recession. The article was also inaccurate in its suggestion that Mr. Peterson applauded the failure of President Obama at the Group of 20 meeting to "persuade his European counterparts ... to maintain economic stimulus programs." Pete and the Foundation strongly believe that short-term economic stimulus to help create jobs and spur growth can and should go hand-in-hand with the development of a plan to address America's long-term structural deficits.

Loretta Ucelli
Vice-President of Communications and Public Affairs
Peter G. Peterson Foundation

A Scary School of Thought

● Many of these behavioral economists ("A Beachhead for the Behavioralists," Politics&Policy, June 28-July 4) are frightening! Perhaps some people really believe government should run everything, but, hopefully, reason will prevail, and these behavioral economists will be shown the door. Maybe they can get jobs in Venezuela or Cuba.

John O'Sullivan
South Plainfield, N.J.

Corrections & Clarifications

● Due to an editing error, "Teachers' Pest" (Features, July 19-July 25) mistakenly said the Gates Foundation is funding outside evaluations of the common curriculum standards "by the Thomas B. Fordham Institute in Washington and the state board of education." The story should have said: "by the Thomas B. Fordham Institute in Washington and the Massachusetts Business Alliance for Education."

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Opening Remarks



Obama and Cameron after their press conference on July 20

MICHAEL REYNOLDS/EPA/CORBIS

After You, Mr. Prime Minister

As the world slides toward a double dip, the pressure for fiscal austerity increases. Obama is lucky that Cameron is going to cut first. By Mark Gilbert

For such charismatic guys, Barack Obama and David Cameron make an awfully chilly pair. At the first White House news conference between the American President and British Prime Minister, their divisions ran deeper than whether beer should be served warm or cold. Cameron acknowledged the legitimacy of U.S. anger over BP's oil catastrophe while defending the company's right to life. (Obama wants to keep BP alive, too—so he can extract cleanup costs.) Obama praised Cameron's condemnation of the Scottish Parliament's decision to free Lockerbie bomber Abdel Basset Ali Al-Megrahi, but in tones that suggested the U.K. still has a long way to go to make amends. Their real flash point, though, concerns economic priorities.

Obama, widely seen as governing from the left, is struggling in the polls because of it. Cameron will remain British Prime Minister only so long as he can reconcile his right-wing instincts with the more centrist approach of his Liberal Democrat coalition partners. Yet both are coming to the same realization: Plugging their economies into the life-support system of central bank liquidity and massive government stimulus packages was the easy part. The tough question is how long their governments should stand in for a private sector too nervous about the future to invest and hire. With the world economy threatening to slide into a double-dip recession, both the U.S. and the U.K. are nevertheless talking about fiscal austerity. The only good news for Obama is that Cameron is going first.

If his nerve holds, Cameron is about to embark upon an unprecedented experiment. He has told government departments to brace for spending cuts of as much as 40 percent as he seeks to shrink both the U.K.'s record budget deficit and a public sector that now accounts for nearly 20 percent of all U.K. jobs.

With the biggest deficit among Group of Seven nations and the worst looming shortfall in Europe this year according to European Union forecasts, the U.K. doesn't want to be the next Greece. Less than a minute into a June 22 budget speech, Chancellor of the Exchequer George Osborne suggested that bond vigilantes are driving U.K. economic policy. "Questions that were asked about the liquidity and solvency of banking systems are now being asked of the liquidity and solvency of some of the governments that stand behind those banks," he said. "I do not want those questions ever to be asked of this country."

Most governments, with apologies to Saint Augustine, would offer a prayer to "make me austere, but not yet." As Marco Annunziata, the chief economist at UniCredit Group in London, puts it: "The austerity debate is now not about whether fiscal tightening in advanced economies is necessary, but on when it should begin in earnest."

That's why policymakers around the world will be watching Britain—especially those at the Federal Reserve, which is not yet ready to follow Osborne's lead. The Fed's colors are still tied to the

mast of maintaining stimulus and keeping borrowing costs as close to zero as possible. At its June 22-23 meeting, the Fed said it would even "need to consider whether further policy stimulus might become appropriate if the outlook were to worsen appreciably."

Fed Chairman Ben Bernanke is concerned that what John Maynard Keynes dubbed the paradox of thrift may kick in if austerity packages are adopted too swiftly and severely. The 20th century British economist, whose work provided much of the blueprint 21st century governments used to drag their countries out of recession, argued that while it makes sense for one or two constituents of a community to save prudently, growth collapses if all of the members simultaneously abstain from spending. Too many governments curbing spending and raising taxes in parallel would snuff out the nascent recovery.

Asked about the U.K.'s austerity plans with Cameron at his side, Obama sounded reliably Keynesian, repeating a warning he had delivered to the Group of 20 nations in April: The world, he said, cannot rely on "an economic model in which the U.S. borrows, consumers in the U.S. borrow, we take out home equity loans, we run up credit cards to purchase goods from all around the world. We cannot alone be the economic engine for the rest of the world's growth." No wonder Obama delivered the line "we speak a common language most of the time" without discernible humor.

He knows that neither the American nor the British consumer is ready to spend. Consumer confidence has dipped, slumping in July to its lowest level in a year in the U.S. and worse than even the most pessimistic forecast of economists. Confidence in Britain is at a six-month low. The housing market remains petrified in both nations. Without an improvement in consumer trust, government aid can't be removed without risking a relapse.

Yet that is Cameron's plan. He has a window of opportunity to push it through by claiming to be cleaning up the mess left by Gordon Brown's administration (just as Obama blames George W. Bush every chance he gets). U.K. government employees, long willing to accept lower wages in return for job security and lucrative pensions, are horrified at the ax heading their way. The Office for Budget Responsibility, a unit created by Cameron to give spin-free assessments of the economy, is predicting 610,000 job cuts in the public sector during the next five years—11 percent of the total public workforce. That would leave 4.92 million workers on the government payroll out of a total of 30 million employed Britons. With so many job cuts, Cameron could find himself coping with strike action on a scale not seen since Margaret Thatcher neutered the nation's private-sector unions.

The banking industry, meanwhile, is crying foul at the prospect of bonus caps and a top income-tax rate that will climb to 50 percent from 40 percent. Threats to leave for Switzerland may prove more than empty.

Cameron, though, has only detailed about half of his planned spending cuts, leaving most of the electorate in the dark about where the ax will fall and his coalition partners nervous about their reelection prospects once their constituents recognize the Faustian pact they've made in exchange for a handful of ministerial positions.

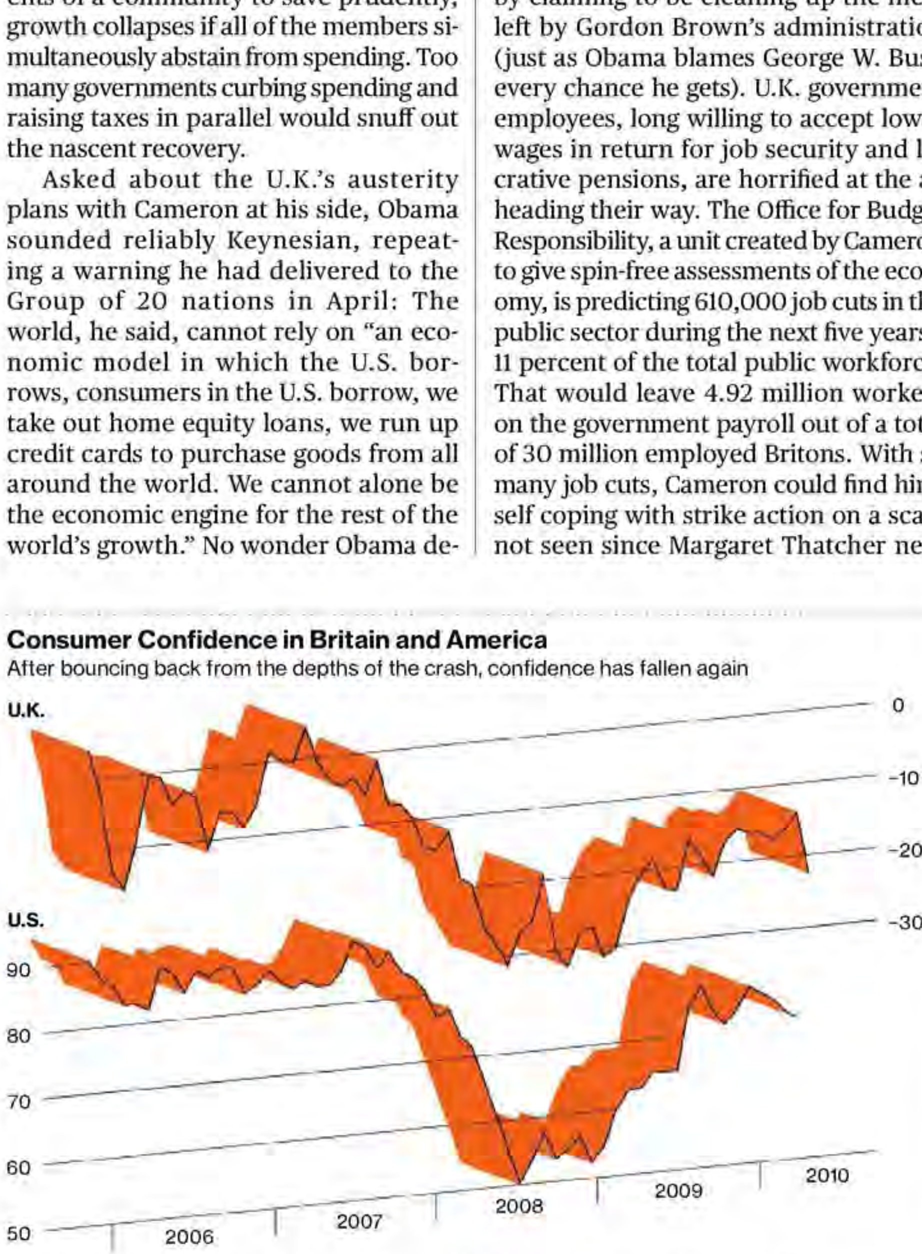
To have any chance at success, he'll have to keep Deputy Prime Minister Nick Clegg, whose Liberal Democrats have enough Parliamentary seats to hold the balance of power, on his side. But Clegg, who agreed to Cameron's icy austerity plan over the objections of many Lib Dem members, has seen his support among voters slump by five percentage points, to 16 percent, since the budget details were released, according to polls by ICM Research and YouGov. Sixty percent of respondents opposed plans to increase the U.K. sales tax to 20 percent from 17.5 percent, the ICM survey showed.

The path Cameron is charting is so arduous, and public opposition is likely to become so intense, that rating agency Standard & Poor's isn't convinced he can deliver and has even said it may cut the U.K.'s credit rating. "A number of large and politically challenging spending decisions are still to be made," it said on July 12. "There is still a material risk that the U.K.'s net general government debt burden may approach a level incompatible with the 'AAA' rating."

The rating agencies have been working their way through the list of profligate EU governments in recent months, starting with the worst offender, Greece, and then cutting the credit grades of other indebted nations, including Ireland, Portugal, and Spain. If Cameron blinks, the U.K. may be next. If he forges ahead, there is a real chance that Britain returns to a recession. Neither scenario is cheery—and neither is beyond imagining for the U.S. Which is why Obama, as he thinks long and hard about whether to embrace austerity or risk the embarrassment of the U.S. losing its AAA rating, is already adopting another durable British invention: the stiff upper lip. **B**

Consumer Confidence in Britain and America

After bouncing back from the depths of the crash, confidence has fallen again



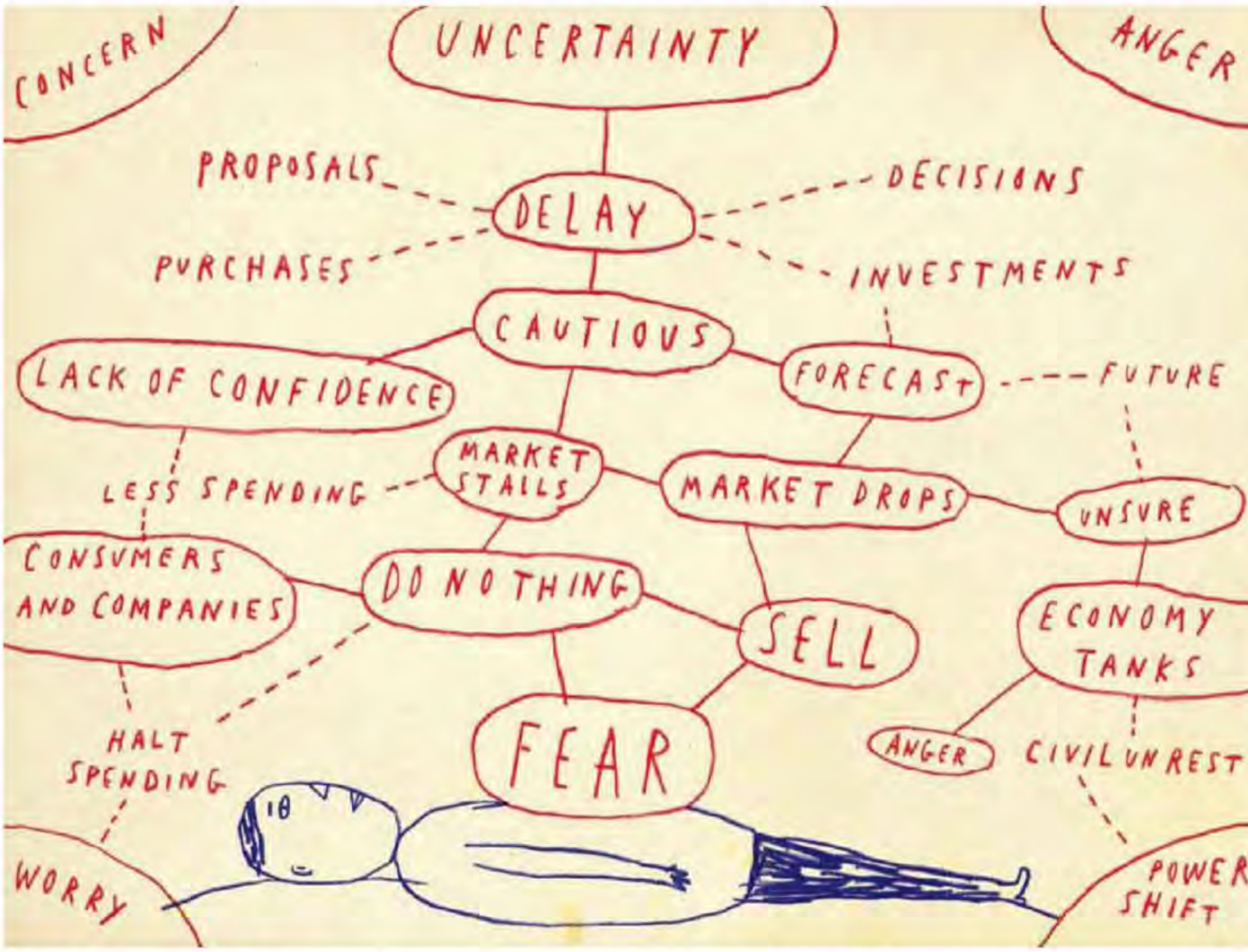
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The Uncertainty Principle: Not Sure? Don't Spend

▶ **Doubts about new regulation and the fate of the economy have corporations playing it safe**

▶ **"It's time for policymakers to...give some certainty to businesspeople"**

Nicholas Bloom, an associate professor of economics at Stanford University and a former adviser to Britain's Treasury, specializes in the study of historical freakouts. He has examined 17 major events—from the Cuban missile crisis to Black Monday in 1987 to September 11 and the fall of Lehman Brothers—and tracked their impact on companies' spending in the months that followed. Each event Bloom looked at created major doubts in the minds of executives about what to do next. Says Bloom: "The optimal response to uncertainty if you're a firm is to do nothing, but if everyone does nothing, the economy tanks."

That realization has made Bloom optimistic about the global economy. "All my money is in the stock market," says the academic. While heightened insecurity can depress growth as companies put off investment and hiring, says Bloom, the effect is only temporary. Output and employment bounce back as anxiety wanes, he explains. His conclusion echoes research published in 1980 by Federal Reserve Chairman Ben S. Bernanke when he taught at Stanford. The "resolution of uncertainty," Bernanke wrote, can lead to "an investment boom" by businesses.

The question is when will the uncertainty clear and the investment boom predicted in Bloom's papers

ILLUSTRATION BY BRIAN REA

Infomercial products hit the shelves
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get under way. Not everyone is as optimistic as Bloom. Larry Kantor, head of research at Barclays Capital in New York, compares the current environment with the malaise of the 1970s, when investors didn't believe government officials could whip inflation. "It's going to be difficult to sustain a bull market, because there's a lack of full confidence in policymakers to get it right," says Kantor.

In the U.S., banks are unsure how much extra capital regulators will require them to set aside. Power companies are waiting to see if the government caps carbon emissions, and human resources departments are still calculating the costs of the 10-year health-care overhaul Congress passed in March. A big unknown is the fate of former President George W. Bush's tax cuts on personal income, capital gains, and dividends, which expire in January unless Congress extends them. The midterm elections could affect all these issues, yet "none of us knows whether Republicans are going to have moderate success, significant success, or historic success," says William Lane, Washington director for construction-equipment maker Caterpillar.

Outside the U.S., many companies are waiting to see how Europe's sovereign debt crisis will play out. No one knows whether China's real estate market is headed for a meltdown. Investors are wondering if any new gov-

"It's going to be difficult to sustain a bull market, because there's a lack of full confidence in policymakers"

ernment can reduce Japan's enormous budget deficit. As Fed Chairman Bernanke told the Senate Banking Committee on July 21, "the economic outlook remains unusually uncertain."

While waiting for the fog to lift, companies are following Bloom's model and playing it safe. U.S. corporations had $1.84 trillion in cash and other liquid assets at the end of the first quarter, up 26 percent from the previous year, according to the Federal Reserve. Japanese businesses held $2.3 trillion in currency and deposits on their balance sheets as of Mar. 31, the most since the Bank of Japan began compiling quarterly data in 1997.

Uncertainty about the new financial regulations is the "most important" reason for delaying a hike in **JPMorgan Chase**'s dividend, Chief Executive Officer Jamie Dimon said to reporters on June 29. Chairman and CEO Howard Levine told analysts on July 7 that **Family Dollar Stores**' earnings outlook is clouded by "what the government is going to do in terms of taxes for the wealthy, benefits for the unemployed." Private-sector payrolls in the U.S. rose only 83,000 in June, less than the 110,000 gain economists polled by Bloomberg News had predicted. Says Mark Zandi, chief economist at New York-based Moody's Analytics: "It's now time for policymakers to... give some certainty to businesspeople so they will go out and hire."

Companies won't get total clarity anytime soon. Figuring out the ramifications of the financial regulation bill passed by Congress will take months. Britain's ruling coalition of Tories and Liberal Democrats has a bold plan to cut the deficit, yet decisions on which programs get the ax won't become clear until October. Some big issues, however, could get resolved more quickly. The one Bloom has focused on is Europe's sovereign debt crisis. The region's regulators have carried out stress tests on their banks to see how the institutions would fare if the euro zone's debt troubles were to intensify. Should the results convince investors that the banks can handle more fallout, that good news could help "in eliminating an enormous overhang over growth," says Raghuram Rajan, a former International Monetary Fund chief economist who teaches at the University of Chicago. Any good news is welcome.

—By Rich Miller and Simon Kennedy

The bottom line *The uncertainty facing companies is reminiscent of the 1970s. When the situation becomes clearer, companies should start investing.*

Real Estate

Where Property Prices Still Hold Up

Home prices in Asian cities, along with some Nordic locations, rose significantly in the first quarter from the year before. While prices eased just 0.23 percent in the U.S., they continued to fall in much of Europe. *—Chris Prentice*

Prices aren't flagging on Hong Kong's Peak, a hot spot since colonial days

Foreigners buying condos in the seaside city of Tel Aviv are bolstering prices

Change in the first quarter from year before, adjusted for inflation

Gained		Lost	
Hong Kong	27%	Greece (Athens)	-5%
Singapore	24%	Croatia	-5%
Taiwan	18%	Spain	-6%
Australia (8 cities)	17%	Slovakia	-9%
Israel	12%	Iceland	-14%
Finland	11%	Ireland	-16%
Sweden	10%	Bulgaria	-19%
China (Shanghai)	8%	Thailand	-20%
Norway	8%	Lithuania	-22%
U.K.	5%	Latvia (Riga)	-32%

There are 621 unfinished or partly vacant "ghost estates" in Ireland

DATA: GLOBAL PROPERTY GUIDE, NATIONAL INSTITUTE FOR REGIONAL AND SPATIAL ANALYSIS, ANGLO-SAXON REALTY



Consumer Prices

For India's Singh, A Tough Inflation Puzzle

▸ Food and fuel prices jump: The poor suffer, and milk costs plenty

▸ Prices were "supposed to come down by now"

In mid-July the Gujarat Cooperative Milk Marketing Federation, an Indian dairy products maker, raised milk prices in New Delhi by as much as 4.2¢ a liter, to almost 64¢. The increase has a real impact on the city's poor, who scrape by on as little as $2 a day. And the government of Prime Minister Manmohan Singh is indirectly responsible: Singh is trying to lower India's budget deficit–it's at a 16-year high–and has started to roll back $5.5 billion in subsidies for gasoline and diesel. With gas prices suddenly higher, it's a lot more expensive to run a fleet of milk trucks. "We were left with no choice but to hike prices as transportation costs have jumped," says R.S. Sodhi, the milk co-op's chairman.

This should have been a good summer for Singh. The economy will probably grow more than 8.5 percent in 2010, much better than last year's 6.5 percent. The Prime Minister no longer needs the two big communist parties in his coalition to pass legislation, so he can push market-friendly reforms such as the elimination of fuel subsidies, which eat up 2.5 percent of the budget .

Yet the specter of inflation is haunting Singh's government. The benchmark wholesale price index jumped 10.5 percent in June from the year before, after a 10.1 percent gain in May. Consumer prices paid by industrial and farm workers in India are increasing at almost 14 percent annually, the highest among 17 countries tracked by Bloomberg in the Asia-Pacific region. In the long run the fuel price increase will encourage companies to use energy more efficiently. For this year, though, the price hike will add about a percentage point to wholesale inflation, according to the Reserve Bank of India, the central bank.

Two other factors are driving inflation. Food prices jumped after 2009's disastrous monsoon resulted in poor harvests of rice, lentils, and sugar. The revival of the industrial economy has created bottlenecks in the supply chain even as the middle class buys more cars, apparel, and other goods. "I've never seen such a time when we had to struggle so hard to make ends meet," says Shweta Kapoor, a housewife haggling over vegetables with a vendor in Faridabad township near New Delhi. "You name it, everything has become expensive."

Singh is under attack for not containing the situation. "Why didn't you release more grains in the market to reduce the impact of the drought?" ex-central bank governor Bimal Jalan asks rhetorically in a Bloomberg interview. The government keeps stores of grain and meat for emergencies: "They could have done a good job making it available," says D.K. Aggarwal, chairman of New Delhi-based fund manager SMC. The opposition Bharatiya Janata Party organized a nationwide strike on July 5 when Singh reduced the fuel subsidies.

Reserve Bank of India Governor Duvvuri Subbarao has reversed last year's loose money policy and raised rates three times since March, to 5.5 percent. "They still have more work to do," says Brian Jackson, an emerging markets strategist at Royal Bank of Canada in Hong Kong. Subbarao wants to curb prices without strangling the recovery–a tough trick to pull off. "We heard inflation will come down by March, then April," says Jalan, who ran the central bank between 1997 and 2003. "It was supposed to come down by now."

Singh's government is calling on Subbarao to get tough. Montek Singh Ahluwalia, deputy chairman of the powerful Planning Commission, said recently the central bank should make "whatever adjustments it feels necessary," as inflation above 10 percent is "not acceptable." Another rate hike is expected when the central bank meets on July 27.

10.5%

Amount India's wholesale price index rose from June to June, hurting Singh

Quoted

"Will there be less credit? I hope so. I hope there will be less subprime loans. I hope there will be less credit default swaps. Don't people understand that unrestricted credit without any backup was a big part of the problem?"
—Rep. Barney Frank (D-Mass.), speaking about the financial regulation bill



CLOCKWISE FROM TOP LEFT: HIGGINS HOOK; BRIAN FINKE. TV: GETTY IMAGES; CARLOS BARRIA/REUTERS; MICHAEL SPRINGER/BLOOMBERG

Global Economics

Singh and Subbarao are both counting on lower food prices by September, when the harvest starts to come in. The 2010 monsoon season is off to a better start. If food prices don't abate, inflation could settle in and require major tightening by the central bank to bring it under control. That would endanger growth—and weaken Singh's government. When milk prices go up, voters take note. —*Kartik Goyal*

The bottom line *Inflation is becoming a major political and economic issue in India. Food prices are largely to blame, and the central bank is under pressure to act.*

Fiscal Policy

Why the Pain in Spain Will Get Worse

- **Lavish spending by regional governments adds to its fiscal woes**
- **"They hired a lot of public servants that they cannot fire"**

Tourists strolling Las Ramblas or gawking at Antoni Gaudi's fanciful cathedral may not notice anything amiss. But beneath the streets of Barcelona, work on an $8.4 billion expansion of the city's subway system has slowed since Catalonia's regional government cut spending on the project by a third this year.

Even as Spain imposes austerity measures to slash its deficit, a fiscal crisis is brewing in the country's 17 regions, which spend almost double what the national government does. After lavishing funds on everything from theme parks to orchestras during a decade-long boom, Spain's local and regional governments have nearly $200 billion in debt. "We have to cut our budget by almost 13 percent next year," says Rosa Rodriguez, deputy finance minister for the Canary Islands. "It's very difficult."

$200 BILLION

The debt owed by Spain's local and regional governments

Regional governments have agreed to a 5 percent reduction in salaries and a promise to replace only 10 percent of retiring employees. Yet "they may have to cut deeper," says Standard & Poor's analyst Myriam Fernandez de Heredia. With Spain's economy forecast to shrink 0.3 percent this year, she warns that tax revenues may fall short of projections.

Spain's regional and local governments are turning to the debt markets to raise some $57 billion this year, far more than their counterparts in any European country except Germany. While German states can borrow cheaply, thanks to their top-notch credit ratings, at least 12 of Spain's regions have suffered recent downgrades. Investors now demand 3.3 percent for Catalonia's 12-month debt, more than a full percentage point higher than what they'll accept for Spain's sovereign bills. That's about triple the difference in 2007.

More than most European countries, Spain has ceded power to regional governments. They finance most education and health care as well as other social initiatives. Spending on such programs has increased even as regional tax revenues have shriveled by almost 9 percent over the past two years. During the boom, regions spent lavishly on projects such as Terra Mitica, a theme park in the Valencia region that features replicas of the Minotaur's labyrinth and an Egyptian pyramid. The park, 22 percent owned by the regional government, doesn't disclose its finances, but opposition politicians say it has lost $350 million since opening in 2000.

Adding to their budget woes, regions have created public companies and foundations to finance everything from stadiums to medical research. The number of such entities has grown to more than 2,000 from about 500 over the past decade. Andalusia, one of Spain's poorest regions, spends $3.9 million a year on a foundation to promote "peace, dialogue, and reconciliation through music," while Madrid's regional government has an agency that provides services to people from the capital who are living abroad. "There was an expansion of spending all around," says Angel de la Fuente, an economist at the National Research Council's Institute of Economic Analysis. "And they hired a lot of public servants that they cannot fire." —*Carol Matlack and Emma Ross-Thomas*

The bottom line *Spain's regions outspend the national government two to one, leaving many of them in dire fiscal straits as tax revenues shrivel.*



Akihabara is a top destination for cash-rich Chinese visitors to Japan

Tourism

Japan: Mandarin Spoken Here

- **Visitors from China may soon be Japan's top tourists**
- **Chinese "buy one thing after another without a second thought"**

Tokyo's Akihabara neighborhood, a warren of narrow streets and storefronts selling every conceivable electronic gadget, is a perennial attraction for visitors to Japan. While it's common to hear a mishmash of foreign languages among the Japanese voices, Mandarin has lately become a growing part of the mix. "My favorite brand is **Sony** because it's the most famous," says Na She, a 42-year-old from China's Hubei province who spent about $1,000 for a Sony camera. "The latest models are hard to find in my town."



CARLOS CERVERA/PANOS

Chinese visitors to Japan may soon outnumber tourists from any other country. Visits from China grew by 0.6 percent, to 1 million last year, while those from South Korea dropped by 33 percent, to 1.6 million, and Taiwanese were down 26 percent, to just over 1 million, according to the Japan National Tourism Organization. The Japanese Foreign Affairs Ministry expects China's numbers to soar to 10 million annually in coming years because of relaxed visa rules for Chinese that went into effect on July 1.

The Chinese are also the biggest spenders, dropping an average of $1,300 per trip, vs. $340 for Koreans and $280 for Americans, according to the tourism organization. If the yuan strengthens, that spending gap could widen. "Chinese people have a strong brand consciousness, and the currency's appreciation would make overseas brands more appealing," says Yoshinobu Uehara, who oversees an $830 million China-focused fund at Sumitomo Mitsui Asset Management.

Akihabara, which started as a black market after World War II, is on the itinerary for more than 40 percent of Chinese visitors to Japan, according to the Akihabara Tourism Promotion Assn. Electronics giant Sony has printed up Chinese-language maps of Akihabara to steer mainlanders to the coolest shops (especially those selling Sony goods, of course). **Yamada Denki**, Japan's biggest electronics retailer, has hired 100 Mandarin or Cantonese speakers. **Laox**, a Japanese electronics chain controlled by Chinese companies, expects customers from the mainland to triple next year because of the easier visa rules. The company is talking with hotel operators and travel agencies about offering Chinese tourists discounts. Says Hajime Kikuchi, a director in Laox's business planning section: Chinese "buy one thing after another without a second thought."
—*Mariko Yasu and Maki Shiraki*

The bottom line *Chinese tourists to Japan may soon outnumber visitors from any other country, and Akihabara's gadget sellers are ready for them.*

The Recovery

The Economy Is A Two-Headed Beast

- **If it's tech, it's hot. Consumer brands are another story**
- **"Being premium-priced is certainly not the strategy [to] pursue"**

Intel Chief Executive Officer Paul S. Otellini told investors on July 13 that he is seeing "renewed economic momentum." A day later, **Yum! Brands** Chief Financial Officer Richard T. Carucci predicted "sustained unemployment and a concerned U.S. consumer."

The contrasting views illustrate the two-speed recovery: Production of business equipment has increased 5 percent this year through June, while output of consumer goods has risen just 0.2 percent, Federal Reserve data show. The likes of Intel, **Microsoft**, and **Oracle** are benefiting as companies replace outmoded equipment and software. Meanwhile, Yum, which owns KFC, Taco Bell, and Pizza Hut, and toymaker **Mattel** are lagging as the 9.5 percent jobless rate takes its toll on consumers.

The stock market has picked up on the two-speed theme. Since April, **PowerShares QQQ**, an exchange-traded fund that mimics the tech-heavy Nasdaq 100 Index, has outpaced the **SPDR S&P Retail ETF**, which includes retail stocks such as **Amazon.com** and **Best Buy**. On its own, the pickup in business spending is not enough to rev up the economy; it's household demand that makes up 70 percent of U.S. gross domestic product. So in June, Fed policymakers trimmed their forecast for U.S. growth this year to 3 percent from 3.5 percent and pledged to keep interest rates near zero. "Policymakers noted that firms' investment in equipment and software had advanced rapidly of late," according to minutes of the June 22-23 meeting. "The rise in consumer spending slowed in recent months after a brisk increase in the first quarter."

Another brisk increase doesn't seem likely soon. Confidence among U.S. consumers tumbled in July to the lowest level in a year, according to the Thomson Reuters/University of Michigan index of consumer sentiment

released on July 16: A record low share of Americans expected their incomes to rise in the next 12 months. No surprise, then, that Yum's restaurants felt the pain, with the company's net income sliding 6 percent, to $286 million, in the second quarter. One bright spot: Yum's $10 value pizzas have been a "huge hit," CEO David C. Novak said on a conference call. "Being premium-priced in [this] environment is certainly not the strategy anyone can pursue," he added. Shoppers are forgoing plastic, too: **Citigroup** reported use of its cards dropped 7 percent in the second quarter.



KFC and other chains are feeling the pain as consumers cut spending

Companies catering to consumers are watching expenditures closely. As a result, inventories rose just 0.1 percent in May, the smallest gain this year. "I don't think anybody is building inventories in anticipation of renewed consumer spending," Mattel CEO Robert Eckert said in a conference call on July 16.
—*Steve Matthews and Anthony Feld*

The bottom line *A two-tiered recovery is under way as business buys new equipment and consumers hold back. The result is slower growth.*

Jobs

Houston, We Have Career Liftoff

▸ The Texas city tops a ranking of the best places for new grads

▸ Instead of "'Who's your daddy?'... here it's, 'What's your idea?'"

Take that, New York! For recent college graduates launching a career, Houston is the American city with the best mix of job openings, pay, and affordability. Rounding out the top five in *Bloomberg Businessweek*'s second annual ranking of the best places for new grads are Washington, Dallas, Atlanta, and Austin. The list of 30 cities was culled from more than 3,500 municipalities based on unemployment rates, the number of employers posting on job search website AfterCollege.com, average pay, and the cost of living.

This year, 13 of the top 30 are new, and five of the newcomers are in Texas, reflecting the strength of the oil industry (for the full list: businessweek.com/go/10/newgrad). Several cities near the top of last year's list didn't make the cut, including No. 1 Indianapolis and No. 7 Chicago. Even in cities that fared well, the number of employers in hiring mode fell. In 2009, Phoenix was No. 2, with 190 employers posting jobs on AfterCollege. This year it's No. 19, with 31 companies listing openings. "The classes of 2009 and 2010 are now competing for the same jobs," says AfterCollege Chief Executive Officer Roberto Angulo. "Internships are going to graduates instead of those who are still in school."

Houston companies have created 31,000 positions since January, including 10,800 in May, according to the Greater Houston Partnership, a business advocacy group. That's a result of a new startup culture that's taking hold, says Jeff Moseley, the group's president. "In some parts, it's, 'Who's your daddy?' and 'Where'd you go to school?'" says Moseley. "Here it's, 'What's your idea and how can we make money?'"

In second-place Washington, the federal government's expansion has created both public- and private-sector jobs, and new grads are drawn by the area's diverse population, international atmosphere, and good universities. Over the past decade, the region added almost 300,000 jobs, though growth has slowed in the past year or two, says Jim Dinegar, president of the Greater Washington Board of Trade, a business group. "We're not recession-proof," Dinegar says, "but we're somewhat insulated." **B**
—*Francesca Di Meglio*

The bottom line *With its low cost of living and 31,000 new jobs added since January, Houston offers recent graduates opportunity on a budget.*



Tom Keene's EconoChat

Tom talks with **John Makin** of the American Enterprise Institute about tax holidays, stimulus, and deflation.

John, you say we've gone from acute to chronic crisis. What do you mean by that?
We threw a lot of stimulus at the acute crisis in 2008, 2009. We got a nice bounce, but the bounce seems to be waning.

Should we have just done more stimulus?
I think we could have designed it a lot better. Spending $800 billion on what amounts to congressional pork is probably not the best way to go. What I and others pushed for was a one-year payroll-tax holiday for both employers and employees. Remember, the payroll tax is a tax on hiring labor. So if you give employers a year off, they're basically going to be more inclined to add workers or less inclined to lay workers off because the cost of keeping people on the payroll has been reduced. It seems like a great idea to me.

Consumers are so frightened, they are paying down debt and not spending. That could lead to deflation. Why should we fear deflation?
Deflation is a condition where prices are falling. The big danger is that it reinforces people not to spend, and at a time when we have a lot of excess capacity, it can become dynamically unstable. That is, I spend less, prices fall faster, and I spend even less. So in Japan you have deflation running about 2 percent. The problem with deflation is that once it takes hold, it tends to accelerate, and it's a very dangerous contractionary force. **B**



Keene hosts Bloomberg Surveillance *7-10 a.m., 1130AM in New York, XM 129, Sirius 130.*

CLOCKWISE FROM TOP LEFT: MARK LENNIHAN/AP PHOTO; ANDREW HARRER/BLOOMBERG; AARON M. SPRECHER/BLOOMBERG


Approved riding area.
"IF IT WAS SIMPLY ABOUT MONEY,
EVERY BANK LOAN WOULD BE A GUARANTEE OF SUCCESS.
At GE Capital, loaning money is the start of the relationship. Not the end. We provide exclusive financing for 1,400 independent Polaris dealers across the country. Providing financing means providing life to these dealers. But it has to be about more than money. We're out there helping Polaris identify new markets, go deeper into existing ones. I've been working with Polaris for 26 years. It's pretty simple math – GE Capital succeeds only if Polaris succeeds. Course, it also helps that I love to ride!"
GE Capital is invested in Polaris.
SCOTT WINE
CEO, Polaris Industries
TOM ORLUCK
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CEO Hackett is distancing himself from partner BP

F. CARTER SMITH/BLOOMBERG

How BP's Spill Tarred Anadarko

▸ **CEO Hackett could do no wrong—until he partnered with BP**

▸ **Costs may "grind the whole company pretty much to a halt"**

James T. Hackett, chief executive officer of **Anadarko Petroleum**, thought he was making a routine decision when he decided to buy a 25 percent share of **BP**'s Macondo well last December. Anadarko was already a partner with BP in the nearby Pompano platform, which would pump the oil to shore. So developing a new field nearby made good economic sense. The well looked relatively simple, and Hackett says he had no reason to doubt the capabilities of BP, one of the world's most experienced deepwater drillers. "This is something that, with any kind of reasonable practices, should have been able to be drilled without a problem," he said in an interview at Houston's River Oaks Country Club.

But in the oil industry, even the easy jobs are high risk. On Apr. 20, the Deepwater Horizon rig drilling the well was rocked by an explosion and later sank in the Gulf of Mexico. Suddenly, everything changed for Anadarko. Under Hackett, the company had grown from a laggard to a star among medium-sized oil and gas players. His strategy: super-charging Anadarko's reliable oil and gas production on the U.S. mainland with successful wildcat exploration in the deep waters of the Gulf of Mexico, and off West Africa and Brazil. That appetite for risk turned Anadarko into one of the premier oil exploration companies.

Now Anadarko's ambitious growth plans and perhaps its existence are threatened. Unless it can find a way out, its share of cleanup costs, fines, and victims' claims could easily add up to billions of dollars. Analysts say obligations that large are likely to put a crimp on the investment capital needed to meet Hackett's 7 percent to 9 percent annual production growth targets.

Anadarko, based in The Woodlands, Tex., has a market value of about $23 billion—down more than $13 billion since Apr. 20—and had $3.7 billion in cash as of Mar. 31. Some estimates put total spill-related costs at as much as $60 billion, meaning Anadarko's share would be $15 billion, assuming it had to pay 25 percent. That sort of tab "would grind the whole company pretty much to a halt for a while," says Philip Dodge, an analyst at Tuohy Brothers.

Anadarko's predicament could turn into a watershed event for the oil and gas business. Exploration companies drilling in U.S. waters and elsewhere have assumed their drilling expertise minimized risks. Instead, it has become clear since the well blowout and subsequent spill that BP and its partners face huge liabilities they never anticipated.

Companies such as Anadarko have fueled the push into frontier areas from the deepwater of the Gulf of Mexico to offshore West Africa, where Anadarko owns 23.5 percent of the massive Jubilee discovery, estimated to hold as much as a billion barrels of oil. If the consequences of the Gulf spill end up endangering Anadarko's financial health, however, that could scare away other independent oil companies from pursuing the kind of lucrative-but-risky drilling that led to the BP spill.

Hackett says he still believes deepwater drilling can be done safely. After staying mum for two months, he lashed out on June 18, blaming the accident on BP's lapses. He said the oil giant's actions "likely represent gross negligence or willful misconduct." Anadarko also has refused to pay a charge of $272 million that BP has billed the company for its share of the cleanup costs. The spill had nothing to do with Anadarko, Hackett said, and was "caused by bad decisions on the rig floor and bad adherence to technical advice."

BP has fired back, saying the co-owners of the Macondo well, which also includes a unit of Japan's **Mitsui Oil Exploration,** were hardly in the dark about what was going on. In fact they "were involved in approving certain key decisions relating

Business and Obama rumble over regs page 27 ▶



to the well," including its design, BP said in a statement. Mitsui Oil's MOEX Offshore 2007, which owns a 10 percent stake in Macondo, says it's reviewing BP's claims and is withholding reimbursement to BP of expenses other than costs not related to the incident.

BP's well design has been criticized by some engineers and other oil company executives as inadequate for a deepwater well like Macondo, which was drilled in a field known for high pressures. "If I'd seen that, I would have asked my company's drilling engineers to explain to me why we're doing it this way, because it doesn't look right," says Don Van Nieuwenhuise, director of petroleum geoscience programs at the University of Houston.

John Brock, an Anadarko shareholder and the former chairman of **Ocean Energy**, a company that merged with one run by Hackett in the 1990s, says the BP-Anadarko spat will likely change oil industry practices concerning oversight of jointly owned well projects. For years, a project's operator has made decisions, "and you just don't look over his shoulder that closely," Brock says. Anadarko likely saw an attractive prospect in owning a piece of Macondo without having to get its engineering people fully involved, he says. "They got enough fires going on in their own house to take care of to think about that."

Fadel Gheit, an Oppenheimer analyst who lauds Hackett's business skill, says he believes Hackett's very public dispute with BP should have been handled privately. "You're in a car crash, and you're fighting with one another," he said. "Let's try to get out of the ditch first before we say who's to blame for putting us in this ditch." Arthur Berman, a geologist who worked for **Amoco** until it was acquired by BP, says Hackett's attack might be part of a legal strategy. The joint operating agreement between BP and Anadarko calls for disputes to be resolved through arbitration, which should be faster and cheaper than going to court. BP and Anadarko also could reach a settlement.

Until the Gulf spill, Hackett, a Harvard MBA, had been an oil industry star who always seemed to make the right move. "He is one of the best guys out there," says Paul Anderson, a BP board member and former CEO of **BHP Billiton**. Anderson hired Hackett as his potential successor as CEO in the mid-1990s at pipeline company PanEnergy. After PanEnergy was acquired by what's now **Duke Energy**, Hackett left to run **Seagull Energy** in 1998. Less than three months later he agreed to merge his new roost with Ocean Energy. Even then, Hackett figured there was money to be made in the deep waters of the Gulf of Mexico and off Africa, and he pushed his company to increase its presence there. "It was a high-risk, high-reward sort of strategy, and it worked because he got the right people," says John Schiller, a former Ocean executive.

When Hackett took the job at Anadarko in 2003, the company was missing its financial targets and was rumored to be a takeover prospect. After quickly righting the ship, Hackett announced his boldest moves: The $21 billion takeovers of **Kerr-McGee** and **Western Gas Resources** in 2006, which added deepwater properties in the Gulf of Mexico and natural-gas fields in the Rocky Mountain region. Some investors panned the moves early on. Yet rising oil prices helped the deals pay off, and Hackett's reputation soared. "He's taken a company that is midsized and really turned it almost into a junior major," says Bruce Bullock, director of the Maguire Energy Institute at Southern Methodist University's Cox School of Business. Now Hackett just has to keep it that way.

—Edward Klump and Stanley Reed

The bottom line *Anadarko CEO Hackett used risky exploration to build his oil company. Now the BP spill risks Anadarko's future.*

Energy

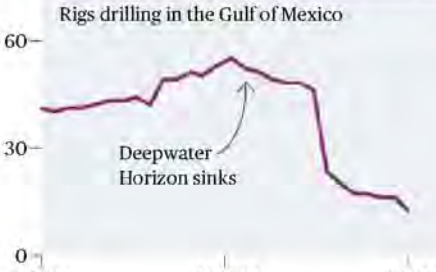
Drilling Slows as Gulf Moratorium Holds

The deepwater drilling ban following the BP oil spill has idled many oil and gas rigs in the Gulf of Mexico (below). Some drillers are sending their rigs elsewhere, and thousands of workers are likely to lose their jobs.

—Zachary Tracer



Rigs drilling in the Gulf of Mexico



8,000

Number of jobs projected to be lost in energy extraction and related fields in Southern Louisiana this year

DATA: BAKER HUGHES, MOODY'S ANALYTICS

THIS PAGE, FROM TOP: SOPHIA MARTINECK; AARON M. SPRECHER/BLOOMBERG. OPPOSITE PAGE: PHOTOGRAPHS BY BRIAN FINKE FOR BLOOMBERG BUSINESSWEEK

At a recent TeleBrands casting call more than 45 inventors showed up. Here are some of the products they pitched.

Retailing

As Seen on TV—And Sold at Your Local Store

- Infomercial goods move from late-night television to retailers' shelves
- The ads are "the movie trailer before the product hits stores"



Roger Escamilla

The **Rinse and Recycle Station** is a sink-side device that uses high-pressure water to clean used cans and bottles, making recycling easier.



Todd Fithian

The **Handle Pro** tops any broom-like handle with a rounded surface to make sweeping, shoveling, and digging easier.



Shayquita Rogers

The **Rogers Ironing Solution** is a heat-proof cover that attaches to an iron after use to protect against burns.



Dennis Rolleri

SuperSanders is a dry wall vacuum attachment that sucks up plaster as you smooth down your wall, reducing cleanup time.



Donna Crossland

Magnets connect two sides of the **Split Decision Blanket**, so a spouse who wakes up hot can easily remove his or her side with ease.



Vito Labbate and son Christopher

After sweeping up the kitchen floor, the **Snap 'n Vac** sucks up dirt, so you don't have to search for a dust pan.

At 5 a.m. on a hot July morning, more than 45 inventors from as far away as Texas and California descended on the Fairfield (N.J.) offices of AJ Khubani, the "Infomercial King" and chief executive of **TeleBrands**. Armed with props such as air mattresses and even a kitchen sink, the would-be-Thomas Edisons prepared to pitch products, including metal-free flatware, an ultraviolet sneaker deodorizer, and a zip-lockable trash bag. The dream: that their invention will become the next PedEgg.

TeleBrands has used its "As Seen on TV" marketing machine to sell more than 35 million of the little gizmos used to smooth rough feet. Such products may be cheap, but they're big business; sales generated by infomercials, or direct-response TV marketing as it's formally known, are expected to rise almost 30 percent, to a record $174 billion, by 2014, according to Yoram Wurmser of Direct Marketing Assn.

One reason for the big uptick: Goods touted in infomercials are increasingly moving onto the shelves of big retailers such as **CVS Caremark** and **Target**. Rather than just enticing viewers to pick up the phone and order from a telemarketing center, the often schlocky TV ads now are used to build the brand before goods are sold at retailers or online. "They're the movie trailer before the product hits stores," Khubani says.

More than 90 percent of TeleBrands' sales now come from major retailers. Drugstore giant CVS says "As Seen on TV" products constitute one of their largest general merchandise categories, and it displays a new item each month at the end of an aisle—prime retail real estate. Those items had double-digit sales growth in the last three years, according to Erin Pensa, a CVS spokesperson. Target has expanded its assortment of infomercial-hawked products in the last two years and has logged strong growth in the past 18 months, says spokesperson Tara Schlosser.

Allstar Products Group—the maker of the ubiquitous Snuggie, basically a blanket with sleeves—has seen sales move from 50 percent at retail to more than 80 percent in the last three years. Allstar has sold more than 20 million Snuggies, which enjoy a cult-like status. Comedian Jimmy Fallon has donned one on his late-night show, and it has been featured in many **YouTube** videos. Snuggie pub crawls have been staged in San Francisco and Knoxville, Tenn.

Traditional advertisers "can't ignore [infomercials] anymore. Before they saw it as carnival-y," says Allstar CEO Scott Boilen. "You can't ignore the Ped Egg, and the Topsy Turvy [Tomato Planter]," which grows tomatoes upside down and has been snapped up by some 10 million customers.

Large companies are taking notice. Tim Hawthorne, founder of **Hawthorne Direct**, an infomercial ad agency, said he recently helped a Fortune 500 client increase retail sales by 100 percent after an infomercial aired for a 10-year-old product. Companies can often recoup advertising dollars even by selling a limited number of items, he says.

That's because ad rates for short infomercials are cheap—as little as $40 for a two-minute spot on a small cable station. Infomercial marketers got a boost during the recession as traditional TV advertisers pulled back, leaving some broadcasters with unsold air time. They filled it with bargain-rate infomercials that ran multiple times. The added exposure helped TeleBrands log record 2009 sales. "We just happened to be at the right place at the right time," Khubani says.

Marketers are scrambling for more products to peddle. Khubani looks for gadgets that solve common problems, sell for between $9.99 and

$19.99, and make people think, "Why didn't I think of that?" He can spot a possible product "in about a minute."

At the periodic Inventor Day competitions that he's started at TeleBrands, inspired by *American Idol*, entrepreneurs whose written proposals sound intriguing get four minutes more than that for their pitches. Rather than use Madison Avenue-style focus groups, Khubani relies on his own gut and a panel of judges that includes his wife of 24 years, Poonam, and a recent addition—his son's math tutor.
—*Matt Robinson*

The bottom line *After years of pitching kitchen gadgets and closet organizers on late-night TV, the infomercial business is going bricks-and-mortar.*

Media

Marc Bell: Porn's Man in The Gray Flannel Suit

- **The FriendFinder CEO wants to add Playboy to his adult empire**
- **"We're the natural acquirer because we ... have the platform"**

There is very little about Marc H. Bell that suggests the sex business kingpin lurking within. Bell does not wear pinky rings or keep his shirts unbuttoned to reveal chest hair and gold chains. Nor does he work in smoking jackets and silk pajamas. Bespectacled and buttoned-down in conservative business suits, Bell is a graduate of Babson College and a member of the board of trustees at New York University, where he earned an MBA. In an interview, he described himself as "a family man with children."

The family of brands at **FriendFinder Networks**, where the 42-year-old Bell is chief executive officer, includes an array of adult properties such as *Penthouse* and websites like adultfriendfinder.com and bondage.com. Now Bell wants to buy one of the most famous names in adult entertainment: **Playboy Enterprises**. He has bid $210 million to buy the Chicago-based publisher of the magazine that became a symbol of the sexual revolution during the Sixties and Seventies but has struggled to remain relevant in an age of hard-core pornography and sexuality served in digital bytes.



Bell sees value where others see irrelevance in an age of digital porn

Bell says FriendFinder, which earlier this year tried to go public, owns 30,000 websites with a vast social networking presence and affiliate partnerships with another 200,000 sites. Together they attract 140 million unique visitors each month. Bell says he would immediately place the Playboy brand on the affiliate network, which would push that traffic to Playboy's digital content.

"We can have a massive impact on Playboy's online presence," he says. "We are the natural acquirer because we're the only ones who have the platform. We'll have huge synergies and the ability to do great things with this from day one."

Standing firmly in the way of Bell's desire to absorb the Playboy brand is Hugh Hefner, who founded Playboy in 1953 and now controls 70 percent of the company's Class A voting shares and 28 percent of the Class B nonvoting stock. Hefner, at age 84, put Playboy's status in flux on July 12 with an offer to take the company private in a buyout valued at $185 million.

Bell, who submitted his competing bid two days later, refuses to say if he has heard from Hefner. He has asked the Playboy board for a meeting. Hefner's only public response to Bell's offer has come via Twitter, where he regularly comments on the daily activity at the Playboy mansion in Los Angeles. "Penthouse really isn't in the picture," Hefner tweeted. "I'm buying, not selling."

FriendFinder, based in Boca Raton, Fla., lost money in 2006, 2007, 2008, and for the first nine months of 2009, according to Securities & Exchange Commission filings. The company has $500 million in debt, much of it owed to Bell, his business partner, real estate investor Daniel C. Staton, and two associates. Bell said he will fund the Playboy purchase by taking on another $150 million of debt. FriendFinder also has $30 million in cash and, if needed, Bell says he and Staton can personally cover the balance. FriendFinder, combined with Playboy, would have about $150 million in annual cash flow, Bell says. "This is very easily bankable. And we may just be the bank."

FriendFinder this year postponed an initial public offering that was planned to raise up to $240 million, according to SEC filings. The company wanted to sell a 49 percent stake to pay down debt. Bell said the IPO was cancelled because the market was weak at the time, and that a buyout of Playboy won't affect plans for a future offering. "When the market is right, we'll go again," he says.

Through his Marc Bell Capital Partners, Bell is an investor in restaurants, nightclubs, films, and Broadway shows. He has Tony Awards for putting on *The Producers* and *Hairspray*. He built the Web hosting company **Globix** and sold a large share of his stake before the company filed for bankruptcy in 2002. Bell and Staton bought *Penthouse* out of bankruptcy for $52 million in 2004, and in 2007 they paid $500 million to purchase **Various**, which included networking site AdultFriendFinder.com.

While others have said that Playboy's demise is due to the proliferation of hard-core adult content, Bell says there's value in owning adult brands that people aren't embarrassed to be associated with. He concedes that his Playboy bid will likely succeed only if Hefner cancels his own bid and joins Bell in a partnership. He wants Hefner to remain as editorial director of *Playboy* magazine and has made it clear to Hefner that he can continue to live in the company's 30-room mansion. Explains Bell, who has a mansion of his own: "I would never move into a smaller house." —*Brett Pulley*

The bottom line *FriendFinder Networks CEO Marc Bell wants to put Playboy content on his online platform. He just needs Hugh Hefner to go along.*

Quoted

"We're not going to kill him. We just want to talk to him."
—Sumner Redstone, chairman of CBS and Viacom, explaining in a voice mail to a reporter why he needed the name of the source of a Daily Beast story discussing Redstone's interest in pushing MTV to do a show on the girl group Electric Barbarellas



FROM LEFT TO RIGHT: JONATHAN FICKIES/BLOOMBERG; TODD WILLIAMSON/WIREIMAGE/GETTY IMAGES; GERALD HOLUBOWICZ/POLARIS

Video Games

GameStop Suits Up To Battle New Rivals



▶ The retailer is trying to bulk up through acquisitions

▶ "If they don't act now, ultimately it puts them out of business"

GameStop is a fast-growing retail chain specializing in sales of entertainment software, where users often battle to the death. Now it's fighting for its own survival. Within weeks, consumer-electronics retailer **Best Buy** hopes to take a hammer to GameStop's highly profitable used-games business by launching a similar service. Meanwhile, **Electronic Arts**, **Take-Two Interactive**, and other game developers are expanding digital delivery of add-ons, which are mini-sequels to games, reducing the need for people to visit GameStop's stores. "If they don't act now, ultimately it puts them out of business," says games analyst Michael Pachter of Wedbush Morgan Securities.

Chief Executive Officer J. Paul Raines says GameStop can repel such threats. To ensure that the Grapevine (Tex.)-based retailer remains a premier destination for gamers, Raines has been adding to his network of 6,500 stores and upgrading flagships into high-tech outlets with touch-screen kiosks where customers can browse the store catalog and pods where they can test-drive games. In November, GameStop purchased **Jolt Online Gaming** for an undisclosed sum and agreed to invest at least $22 million in game development over two years. "The video game industry is evolving into different platforms beyond the console, and GameStop is well positioned as a multichannel retailer and aggregator for all things gaming," says Raines.

The specialty chain's investors aren't as confident it will survive the transition. Sales have tripled since



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2006, to $9.1 billion, with much of the growth coming from used games, which now account for 27 percent of all revenues. Gamers trade in old titles for store credit and the company then resells each game for nearly twice as much. Best Buy plans to one-up GameStop by letting customers exchange old games for gift cards that can be used to purchase merchandise at any of its stores. GameStop's shares fell as much as 9.5 percent during intra-day trading on June 15, the day Best Buy announced the move.

GameStop executives say they aren't concerned. Teens and young adults looking to trade in their games often come to GameStop because it is close to home, while many Best Buys are located in more distant malls, says Bob McKenzie, senior vice-president for merchandising. McKenzie also believes Best Buy will be hard-pressed to replicate his stores' customer experience: "We respect Best Buy, but because we are a specialty retailer that focuses solely on gaming, people really value coming in and talking to our associates." Best Buy's Chris Homeister, senior vice-president for entertainment, responds that gamers will be drawn to the wide assortment of products at the company's 700-plus stores. "Consumers are looking for alternatives," he says.

If Best Buy were the only threat to GameStop's gaming empire it would have less to be concerned about. But like **Blockbuster** and **Hollywood Video**, GameStop has been struggling to adjust to the shift to online sales of games and other content. It also faces a revolt from game publishers, who derive no benefit from sales of used games. To counter the trend, developers now include one-time-use coupons for downloadable content and upgrades to reward people who purchase a new game. People who buy used games from GameStop or elsewhere must pay an extra $10 or more for the same goodies. That can boost the price of the used game to more than that of a new one. "It's clear publishers will continue to combat used-game sales, likely taking more aggressive tactics in the future," said Janco Partners analyst Mike Hickey in a research note in June.

Raines believes the used-game business will keep growing but says GameStop is on the hunt for acquisitions that will help solidify his digital strategy. Media and entertainment analyst Tony Wible at Janney Montgomery Scott figures targets could include **OnLive**, a Palo Alto (Calif.)-based startup that streams games through broadband, Bellevue (Wash.)-based **Valve's Steam** online game platform, which has about 2 million members, and French digital distribution company **Metaboli**, which owns U.S.-based download service **GameTap**.

With its light debt load and free-cash flow, GameStop has the luxury to shop around. Those same assets could turn the company into an attractive takeover target itself. That's one reason the stock has been on a roller-coaster ride this year. One potential suitor is the same guy looking to eat GameStop's lunch: Best Buy. —*Cliff Edwards*

The bottom line *With a powerful new competitor in Best Buy, the video-game retailer GameStop is racing to build up its digital offerings.*

Mining

A China Miner In a Heap of Trouble

- Regulators investigate a big gold and copper producer over pollution
- "It's not like five to 10 years ago. ... Now, neglect must be repaid"

Until recently, **Zijin Mining Group**, much like the Chinese economy, was on a roll. Sales have grown 68-fold in the past decade. Zijin became the mainland's largest publicly traded gold producer, a major supplier of copper, and had big international growth plans. Then came a leak of 2.4 million gallons of acidic copper waste from Zijin's flagship mine in Fujian province in early July that resulted in a polluted river, almost 2,000 metric tons of poisoned fish (enough to have fed 72,000 people for a year), and a probe by Chinese regulators into the timing of the disclosure of the mishap.

Now, Zijin may find its growth stymied. "For the next one or two years, the company will have to focus on cleaning up, and their expansion plans in and out of China may be put on a backburner," said Helen Lau, a Hong Kong-based analyst at UOB Kay Hian. Zijin Chairman Chen Jinghe planned to make two major overseas acquisitions this year after buying $200 million of Swiss commodity trader **Glencore International**'s convertible notes.

Jinghe delayed disclosing the leak at its biggest mine, Zijinshan, for nine days, prompting the government probe. Waste water containing acidic copper seeped into the Ting River on July 3 from its plant at Zijinshan mine, the company said on July 12. Zijin had initially blamed rains for the leakage near Shanghang county, where about half a million people live. The Fujian-based company was cited for seven environmental violations last year.

Zijin's already weakened stock price plunged 12 percent the day after it announced the leak. (The shares have dropped about 37 percent in Hong Kong and 41 percent in Shanghai this year.) Company officials are trying to restore investor confidence. "We need



Draining polluted water near the Zijin copper mine in Shanghang

THIS PAGE: AFP/GETTY IMAGES. OPPOSITE PAGE: REDBOX: RICK WILKING/REUTERS; UNILEVER: UPPA/ZUMA PRESS

to rethink our corporate values and improve management," spokesman Zhao Jugang said in an interview. "We should make continued investments in environment and safety measures. This is a big lesson for Zijin." He said the company plans to invest 200 million yuan ($30 million) within a year on environmental and risk measures.

Zijin "focused too much on expansion and neglected efforts on internal management, risk control, and the environment," says Yi Yangfang, investment director at GF Fund Management. The Fujian government earlier this year delayed approval of Zijin's $480 million purchase of Australia's **Indophil Resources** for three months. In June, Zijin canceled the deal, which would have given it a stake in Southeast Asia's largest untapped copper and gold deposit. The delay "indicates an awkward relationship with the local government," says Leo Gao, who helps oversee $600 million at APS Asset Management in Shanghai. "The company's low-cost, old mining methods pose huge environmental risks. It's like a sword hanging over their head."

Chairman Chen decided to use leaching, which generates cyanide waste, to extract metal at the Zijinshan mine because only 0.3 grams of gold can be obtained from each ton of the mine's very low-grade ore. It costs only 60 yuan to produce a gram of gold at the mine, compared with 110 yuan at rivals', according to Zijin.

The company shut its copper smelter, where the leak occurred, and doesn't know when it will reopen, spokesman Zhao said. Beijing may make an example of Zijin as it seeks to highlight a more serious stance toward environmental issues, Bank of America Merrill Lynch said in a July 12 report. Beijing has ordered the closure of polluting plants and issued new standards for steelmakers and smelters in the past year.

"Investors now want a model of sustainable growth, a model that not only shows profit growth but also a commitment to social responsibility," UOB's Lau said. "It's not like five to 10 years ago when companies could get away with what you want. Now, neglect must be repaid." —*Xiao Yu*

The bottom line *Zijin Mining is under investigation after an acid leak at its mine in Southeastern China, just as Beijing is cracking down on polluters.*

In brief

by Cristina Lindblad



Consumer finance helped rev up Harley Davidson's second-quarter performance

Harley-Davidson
The Finance Unit Turbocharges Profits
Shares in the Milwaukee-based motorcycle maker jumped 6 percent on July 20 after it reported a $139.3 million profit for the second quarter, a fourfold increase from the same period last year. The improvement owed much to a dramatic turnaround at the consumer-loan unit, which helps finance the sales of Harleys and had operating income of $61 million, compared with a $91 million loss a year earlier. Harley is set to begin negotiating labor deals expiring in 2012. The company is on a drive to cut costs and make its production schedule more flexible. To that end it has pared back its union workforce in the Northeast and wants some employees in Wisconsin to become part-timers.

Jive Software
An Infusion for a Social Networking Startup
Kleiner Perkins Caufield & Byers and Sequoia Capital, the venture firms that made billions of dollars backing Google, are investing $30 million in Jive Software, a maker of social-networking technology for businesses. More than 3,000 companies, including Intel, Nike, and VMware, use Jive's software to help employees communicate with one another and with customers. Businesses pay annual fees of about $100 per user, which includes the costs of hosting the service. Revenues at Palo Alto (Calif.)-based Jive jumped 85 percent last year and its workforce has more than doubled, to 275 employees. The startup may file for an initial public offering as early as next year.



Coinstar
Thinking Outside The Red Box
Redbox became the fastest-growing U.S. video retailer with its DVD kiosks and $1-a-day rental price, which video store chains couldn't match. Now the company, a division of Coinstar, is drafting a Web strategy, President Mitch Lowe tells Bloomberg. Redbox, which saw sales from its 24,000 or so DVD dispensers soar 70 percent in the first quarter, is looking to narrow the gap with rival Netflix, which boasts a much bigger selection of movie titles. While Lowe declined to give specifics, analysts speculate that rather than develop an online service in-house, Redbox may choose to team up with another company to deliver movies on demand over the Internet. Ralph Schackart, an analyst at William Blair & Co., believes one potential partner could be Sonic Solutions, an outfit that provides technology and a library of about 20,000 titles to clients including Best Buy and Sears. Both Coinstar and Sonic declined to say whether they are in talks.

British Airways
A Pact with Unions Eludes Walsh
The cabin crew union of British Airways rejected a pay offer aimed at resolving an 18-month dispute over compensation and working conditions. The carrier now faces the prospect of renewed strikes. Walkouts have cost BA $235 million this year. Yet the main union may find it more difficult to wring concessions from Chief Executive Officer Willie Walsh as less than half its members turned out to cast a vote. Walsh scored a victory on another front when U.S. antitrust authorities granted final approval for BA and American Airlines to jointly set prices, sell tickets, and schedule flights through their Oneworld Alliance.

Gilead Sciences
A Breakthrough In AIDS
A vaginal gel containing Gilead Sciences' AIDS drug Viread cut HIV infections by as much as 54 percent in a trial in South Africa, the first time such a product has protected women after six previous gels failed. The gel was developed by Conrad, a U.S. nonprofit, under royalty-free license from Foster City (Calif.)-based Gilead, the world's biggest maker of AIDS medicines. The notion that drugs can be used before exposure to prevent HIV infection could revolutionize the fight against AIDS, particularly in Africa where the epidemic rages on.

Unilever
The Strategy: Sell Local, Buy Global
Unilever is selling its Italian frozen-foods unit, Findus, as part of its strategy of unloading local labels in order to focus on international brands. Birds Eye Iglo, which is owned by buyout firm Permira, will pay $1.04 billion for the business. Unilever now plans to buy Sara Lee's shower gel and European detergents business for $1.7 billion, its first major deal in nine years. Paul Polman (pictured below), CEO at the world's No. 2 consumer-products company, has earmarked as much as $2.6 billion a year for so-called bolt-on acquisitions.



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Politics&Policy

Big Business Takes on Obama

▶ **The high jobless rate provokes a fight over regulations, taxes, and trade**

▶ **The coming regulatory explosion is "an economic Katrina"**

This confrontation had inevitability written all over it. The only question was: When would the White House and Big Business really start to rumble? Both sides are certainly clashing now over a crush of new rules to overhaul industries ranging from health care to financial services to offshore drilling. **Verizon Communications** CEO Ivan Seidenberg says business leaders must make sure the Obama Administration's regulatory cures aren't "worse than the disease," adding that the Administration hasn't done enough to pry open foreign markets and keeps trying to raise corporate taxes. Mort Zuckerman, chairman of commercial real estate firm **Boston Properties**, calls the coming regulatory explosion "an economic Katrina."

President Barack Obama isn't being subtle, either. On July 7, he said new regulations are needed to control "unscrupulous and underhanded businesses who are unencumbered by any restrictions on activities that might harm the environment, or take advantage of middle-class families, or threaten to bring down the entire financial system." (Zuckerman calls the remarks "totally gratuitous.")

As Obama signed the financial regulation reform bill on July 21—only a handful of bank CEOs were invited to the elaborate signing ceremony—he said the new law will "make sure that everyone follows the same set of rules, so that firms compete on price and quality, not tricks and traps." The measure will require 520 new rules, 81 studies, and 93 congressional reports, figures the U.S. Chamber of Commerce.

On the surface, worries over taxes, trade, and regulations are



ILLUSTRATION BY SOPHIA MARTINECK

driving the Obama and business split. Yet both sides are also playing a rhetorical blame game over the weak economy. The jobless rate is 9.5 percent, and corporate America and the Administration think the other side is not doing enough to create new jobs. Obama wants companies to spend part of their $1.8 trillion cash stockpile to create new products and open factories to generate employment. If the President wants to create jobs, business executives counter, then he should back off the regulatory onslaught and give business more certainty about the future.

While both sides say they want to tone down the rhetoric, the disagreements aren't likely to disappear: Their policy differences are too fundamental. There is also ill will left over from the health-care reform battle and a White House attempt to tax companies' overseas earnings.

In late spring, at a series of White House meetings, Business Roundtable executives told Obama aides they felt betrayed when they learned they would lose a subsidy under the Medicare prescription drug program. The group had supported health-care reform and believed the Administration, in return, would continue to support the $5.4 billion, 10-year subsidy that companies get for providing prescription drug benefits to retirees and workers over 65, saving the Medicare program money.

Weeks later, Seidenberg, who chairs the Business Roundtable, an association of large-company CEOs, sat on a panel with Budget Director Peter Orszag and told him "that the cost of regulation wasn't accurately factored into some of the policies that were coming out," Seidenberg says. Orszag asked for a memo detailing his concerns. The Business Roundtable and the Business Council, a separate group of CEOs, obliged with a 49-page compilation of dozens of regulations.





Obama after signing the financial reform bill into law on July 21

Thanks for the list, let's talk, White House aides responded, while signaling that most new regulations are not up for discussion. In a July 14 letter to the Chamber, Obama Chief of Staff Rahm Emanuel and Senior Adviser Valerie Jarrett said they would not "accept the lax regulation of the financial industry that led to the greatest economic crisis since the Great Depression." Ditto for the oil and gas industry, given the ecological disaster in the Gulf of Mexico. "It's one thing to say generically 'regulations are bad,'" says Jarrett. "It's another thing to come in and to explain to us very specifically why they are an impediment to competition."

Some of the differences are rooted in economic dogma. The White House says it is open to business proposals on cutting taxes—only if it doesn't reduce the overall corporate tax burden, Seidenberg says. "Our view is if we can expand work and create jobs we'll create new tax revenues" even if tax rates don't go up.

Business will never be satisfied, says Dean Baker, co-director of the Center for Economic & Policy Research in Washington. Companies always want lower taxes and less regulation, he says. "It doesn't matter where the tax is, they want to pay less."

The discord "is unhealthy for each side," Roger Altman, founder of Evercore Partners and a former Deputy Treasury Secretary under President Bill Clinton, told Bloomberg Television on July 21. "I think it can suppress just that level of business confidence that's necessary to create investment and jobs," Altman said, suggesting that each side bury the hatchet, with business going first.
—Kate Andersen Brower

The bottom line *The White House and Big Business are unlikely to end their spat soon because their differences are too fundamental.*

Major Corporate Gripes

Corporate Taxes	Trade Deals	Financial Regulation	Labor Relations	Greenhouse Gases	Broadband
Proposals to raise taxes on foreign earnings would harm the ability of companies to compete overseas.	Incomplete free-trade pacts with South Korea, Colombia, and Panama put U.S. companies at a disadvantage to foreign competitors.	The financial overhaul requires companies to post collateral for derivatives trades, raising hedging costs. It also lets shareholders nominate directors, allowing special interests to shape boards.	Proposed "card-check" legislation making it easier for unions to organize would eliminate secret union ballots and would have a "devastating impact" on business.	Environmental Protection Agency proposals to limit carbon emissions will raise costs and lead to layoffs by manufacturers.	The Federal Communications Commission's Net neutrality proposal, which would prevent Internet providers from varying download speeds, will make it hard to handle traffic efficiently.

DATA: BUSINESS ROUNDTABLE

LEFT TO RIGHT: ILLUSTRATION BY SOPHIA MARTINECK; WIN MCNAMEE/GETTY IMAGES; PETE SOUZA/THE WHITE HOUSE

Five of seven groups of corporate executives invited to White House lunches have seen their shares as a group outperform the S&P 500

The White House

Stockpicking Tips From President Obama?

- Shares of companies whose CEOs dine with Obama outdo the S&P
- "Obama is trying to associate himself with winners"

	CEO	Best & Worst Performers		S&P 500 30-Day Gain	30-Day Average Gain for All Attendees
Lunch 1 06/25/09	Ursula Burns	Xerox	+29.4%	 +10.7%	**12.7%**
	David Cote	Honeywell	+13.9%		
	Muhtar Kent	Coca-Cola	+4.0%		
	Randall Stephenson	AT&T	+3.7%		
Lunch 2 07/31/09	Howard Schultz	Starbucks	+12.8%	 +5.7%	**4.1%**
	Daniel DiMicco	Nucor	+5.6%		
	Mike Duke	Wal-Mart	+1.5%		
	Ivan Seidenberg	Verizon	-3.5%		
Lunch 3 10/08/09	Jeff Bezos	Amazon	+39.7%	 +4.9%	**8.3%**
	Irene Rosenfeld	Kraft Foods	+4.6%		
	Lew Hay	FPL Group	-2.4%		
	Antonio Perez	Eastman Kodak	-8.4%		
Lunch 4 01/26/10	Mort Zuckerman	Boston Properties	+11.3%	 +4.0%	**7.7%**
	Jim Hackett	Anadarko	+9.7%		
	Jamie Dimon	JPMorgan Chase	+8.2%		
	Rex Tillerson	ExxonMobil	+1.4%		
Lunch 5 02/04/10	Frederick Smith	FedEx	+12.8%	 +6.2%	**5.9%**
	Tom Wilson	Allstate	+5.2%		
	David MacKay	Kellogg	-4.3%		
	Richard Dugas	Pulte	+1.1%		
Lunch 6 03/09/10	Glenn Tilton	United Airlines	+24.3%	 +6.0%	**13.2%**
	Jim Skinner	McDonald's	+8.0%		
	Greg Brown	Motorola	+7.4%		
	Penny Pritzker	TransUnion	N/A*	*TransUnion is not publicly traded	
Lunch 7* 07/01/10	Alan Mulally	Ford	+16.6%	 +4.8%	**9.3%**
	Brian Roberts	Comcast	+8.6%		
	Pat Woertz	ADM	+6.0%		
	Bob Iger	Walt Disney	+6.0%	*Includes only 13 trading days	

Money managers tout their investing strategy in books, at seminars, and on blogs. Some call it a science, others an art form. And then, of course, there's luck. In that spirit, here's one more stockpicking technique to add to the list: Take a look at who is lunching at the White House.

Since becoming President, Barack Obama has held seven lunches with small groups of chairmen and chief executive officers, including Jeff Bezos of **Amazon.com**, Ken Chenault of **American Express**, Ursula Burns of **Xerox**, and Howard Schultz of **Starbucks**. In four of the lunches, the guests' companies, as a group, outperformed the Standard & Poor's 500-stock index 30 trading days after the repast. In two cases, the groups' shares underperformed the S&P 500 a month after lunch with the Commander-in-Chief. Altogether, the six lunch groups outdid the S&P by more than two percentage points. Thirty days haven't elapsed since a seventh lunch held on July 1.

Just a coincidence? Only partly, says Barry Ritholtz, CEO of equity research firm Fusion IQ. Losers don't get asked to hang out with the President, he says. The White House likely is putting together invitation lists so that the President is dining with executives at the top of their games and not associating with companies in decline or under investigation. "If the captain of your team gets a phone call from the White House, it probably means your team is about to win the World Series or already has won," Ritholtz says. Adds Andrew Rudd, CEO of Advisor Software: "Obama is trying to associate himself with winners and it's sort of potentially reinforcing."

Of course, not every one of the 33 publicly traded companies' share prices rose. **Eastman Kodak** fell 8.4 percent in the 30 trading days after Chief Executive Antonio Perez dined with Obama on Oct. 8, 2009. (The company reported its fourth-straight quarterly loss later that month.) On the plus side, Amazon shares rose 40 percent after Bezos attended the Oct. 8 lunch.



Rudd, whose Lafayette (Calif.) company provides analytical tools to wealth managers, cautions against building an investment strategy around the President's guest lists. The sample size is too small, Rudd says, and the shares' outperformance is probably a statistical anomaly. Still, he says: "I'm sure people will bet on this, just as certain people pick companies with stock prices at 9.99 or the same names as their aunts."

The President's stockpicking magic is still working. On July 1 he lunched on a patio outside the Oval Office with the heads of **Walt Disney**, **Ford Motor**, **Comcast**, and **Archer Daniels Midland**. Thirteen trading days later, as of July 20, their companies' shares had risen an average of 9.3 percent vs. 4.8 percent for the S&P. —*Nicholas Johnston*

The bottom line: *President Obama's choice of corporate executive lunch guests shows he's pretty good at picking winners.*

The market shrugs off "Antennagate" page 34 ►



Campaign Finance

The Republicans' Money Momentum



► Fund-raising figures point to trouble for Democrats in November

► "The competitive races are the red flag for Democrats"

Democrats have a lot to worry about these days, and now they have one more thing: In races for open seats—42 in the House, 14 in the Senate—Republicans are gaining momentum in fund-raising. "Open seats are much easier to win than knocking off incumbents," says John Fortier, a fellow at the American Enterprise Institute. A financial advantage makes it even easier.

Republicans competing for seven closely contested open Senate seats raised millions of dollars more as a group than their Democratic rivals in the second quarter. On the House side, Republican candidates in 10 hard-fought races for open seats had more money in their campaign war chests than their Democratic opponents as of June 30.

Republican fund-raising success adds credibility to opinion polls that suggest the party is poised to pick up seats in both houses in November. "The competitive races are the red flag for Democrats," says Julian Zelizer, a professor of history and public affairs at Princeton University. The House fund-raising figures, he says, "suggest that Republicans will be able to make significant dents" in the Democratic majority. Linda L. Fowler, a Dartmouth College government professor, says the second-quarter Senate results "suggest a classic cycle of donors deciding this is a good year for Republicans, giving them money and reinforcing the existing advantage of national tides."

One sign of trouble for Democrats is in Florida, where Marco Rubio, the Republican candidate for Senate, brought in more than $4.5 million from Apr. 1 through June 30, his campaign filing says. Democratic opponent Kendrick Meek raised more than $1 million, according to his website. Governor Charlie Crist, the independent candidate, drew $1.8 million. Republicans running for open Senate seats in Illinois, Indiana, Missouri, New Hampshire, Ohio, and Pennsylvania also out-raised rivals. A backlash against Democrats, who have controlled Congress and the White House during the two years of financial crisis and fierce legislative combat, appears to be boosting Republicans in the money race. Republicans would need to gain 10 Senate seats and 40 House seats to win control of each chamber.

Another source of worry for Democrats is Nevada. Former Republican state legislator Sharron Angle has brought in almost $2.6 million in her bid to unseat Senate Majority Leader Harry Reid. The incumbent collected $2.4 million, although he has almost $9 million in the bank.

Other Democratic incumbents fared better last quarter. Arkansas Senator Blanche Lincoln, California Senator Barbara Boxer, and Colorado Senator Michael Bennet brought in more campaign cash than Republican challengers. Boxer raised $4.6 million, compared with $3.3 million for her Republican rival, former Hewlett-Packard Chief Executive Carly Fiorina, whose total includes $1.9 million she loaned her campaign.

Princeton's Zelizer says he expects Democrats to retain their majority in the House, where the most vulnerable Democratic incumbents still have more money to spend overall than their Republican challengers. Still, it's likely to be a tough summer and fall for President Barack Obama and his party, says Rogan Kersh, associate dean at New York University's Wagner School of Public Service. "There's greater political energy on the Republican side right now, which spills over into donation patterns."

—*Jonathan D. Salant, Kristin Jensen, and Patricia Laya*

The bottom line *Democrats' mounting political challenges include growing Republican momentum in the vital race for campaign cash.*

Elections

Under Attack, Pollsters Debate Their Methods

► Accusations of faked data and nonscientific methods

► "Every month, it's harder and harder to do this job and do it right"

In June, Blanche Lincoln, the two-term moderate Democrat from Arkansas, faced a tough run-off primary against Bill Halter, the state's more liberal lieutenant governor. Polls showed he had pulled ahead by as much as 4 percent-

Drawing Board



THIS PAGE, FROM LEFT: ILLUSTRATION BY TOPOS GRAPHICS; ILLUSTRATION BY MATSON/CAGLE CARTOONS. OPPOSITE PAGE: BETH ROONEY/THE NEW YORK TIMES/REDUX

age points. Lincoln veered left, attacking Wall Street and rebuffing requests from the White House and Federal Reserve to weaken a proposal she put in the financial regulation bill to impose tough rules on derivatives trading.

Lincoln's victory in that primary has set off a war over polling and the way it has been transformed by the Internet and cell phones. **Research 2000**, the only polling firm that released data publicly in the weeks before Lincoln's June 8 runoff, has been accused of falsifying its numbers in a lawsuit filed by the liberal blog **Daily Kos**, which commissioned the polls. Other pollsters are also under attack. In September, the American Association for Public Opinion Research publicly rebuked Atlanta-based **Strategic Vision** for failing to disclose its methodology after being accused of falsifying polls it conducted before the 2008 Presidential primaries in New Hampshire and Wisconsin.

The two episodes have prompted a vigorous debate over the reliability of polls and how they drive politics and policy. In the spotlight is the tight-knit, largely unregulated community of pollsters, whose efforts to obtain scientific results have been made far more difficult because of the Internet and mobile technology. "Something has got to change," says Nate Silver, who ranks pollsters on his popular website, **FiveThirtyEight.com**. "These were two fairly prominent pollsters who were accused of just making data up out of thin air." Silver, whose blog will be hosted on *The New York Times* website beginning in August, is embroiled in a polling controversy of his own: He has called **Zogby International** the "worst pollster in the world," arguing that Zogby's Internet-based surveys rely on an unscientific sample of participants who volunteer on the Zogby website. Chief Executive Officer John Zogby says his results are accurate, and spokeswoman Leann Atkinson says the company is preparing an article questioning Silver's methodology for ranking pollsters.

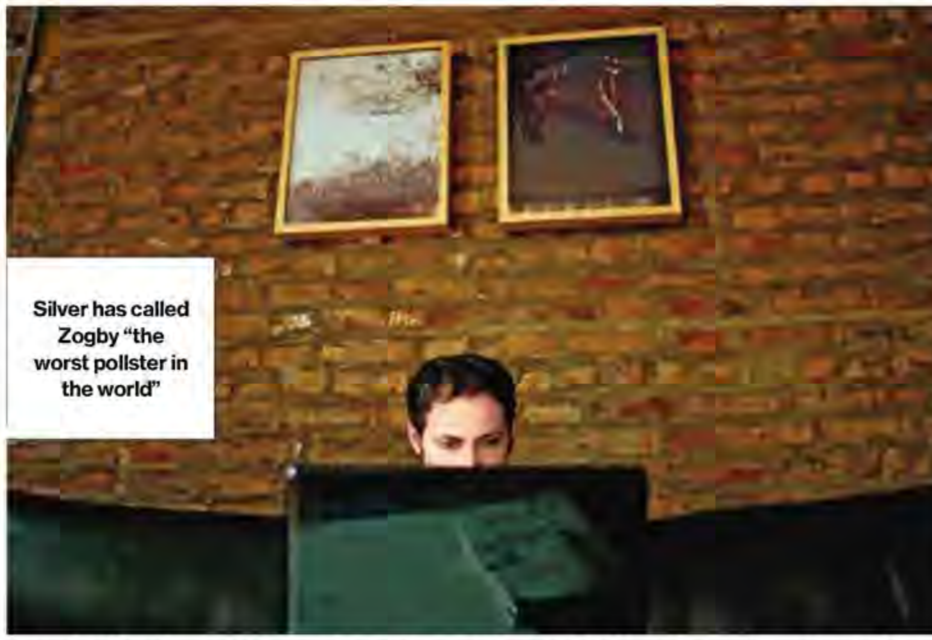
Polls are attracting attention because they increasingly feed an Internet-driven appetite for 24/7 political news. Negative poll numbers can deliver a fatal blow to candidates or make it difficult to raise money and build grassroots momentum.

Daily Kos says it discovered flaws in the Arkansas polls after it was approached by three statistical experts. The website began an investigation and, on June 29, Kos founder Markos Moulitsas published his conclusion that the site was defrauded by the polling company. The following day, Daily Kos sued Research 2000 for more than $100,000 in damages for breach of contract, misrepresentation, and fraud. The pollster's president, Del Ali, has denied the allegations. His lawyers declined to comment. Lincoln spokeswoman Katie Laning Niebaum says the poll "was not a factor" in the senator's decision to push her derivatives proposal, which ultimately was included in modified form in the final law. Halter's aides, who touted the polls during the race, say they privately questioned the Research 2000 results.

The cost of conducting scientifically sound polling has increased. Scott Keeter, director of survey research for the Pew Research Center and incoming president of the American Association for Public Opinion Research, says only about 20 percent of people contacted agree to take part in political surveys. That reluctance has forced pollsters to try new methods to get a statistically sound sample size. More than 20 percent of all U.S. households now only use cell phones, according to government statistics released in May. Including those users in surveys drives up polling costs because lists of cell-phone users cost twice as much as standard lists of registered voters, says J. Ann Selzer, president of polling firm **Selzer & Co.**, whose clients include Bloomberg News. "Every month, it's harder and harder to do this job and do it right," says Selzer.

Many research organizations are turning to the Internet, though that method is also fraught. To get a correct sample, every participant must have an equal chance of being contacted, says Selzer, the top-ranked pollster in Silver's 2008 rankings. A truly random sample is hard to achieve online, given that there's no national registry of e-mail addresses. "The Internet violates sampling 101," Selzer says. —*Lisa Lerer*

The bottom line *Polling's influence in politics and policy is growing as the reliability of some polls is declining.*



Silver has called Zogby "the worst pollster in the world"

Media

The Window Is Open for Comcast Competitors

- An antitrust review of the NBC Universal deal gives rivals a say
- "The big question is the degree of concessions"

Comcast, already the largest U.S. cable operator, is on the verge of getting a lot bigger. First it has to make nice with the competitors, programmers, minority groups, and other special interests that fear an even more powerful Comcast after its $28 billion acquisition of

General Electric's NBC Universal unit. The Federal Communications Commission and the Justice Dept.'s Antitrust Div. are reviewing the purchase, and thousands of public comments have been filed at the FCC.

The company is trying to neutralize opposition to the merger and ease antitrust concerns with a simple strategy: Make deals to get the deal. As in past media mergers, rivals and special interests have drawn up lists of demands that are the price of their support, and Comcast is whittling them down one by one. The latest: Comcast and NBCU agreed on July 12 to hold regular meetings where independent producers—who initially opposed the acquisition—could pitch their ideas for shows.

Founded in 1963 with the purchase of a Tupelo (Miss.) cable system with 1,200 customers, Comcast has expanded to 23.5 million cable subscribers. With the NBCU acquisition, the company would control a movie studio, 10 NBC stations, sports and Olympics programming, and cable networks such as Bravo, CNBC, MSNBC, and USA Network.

The Comcast-NBC combo would have a broadcast station and sports network in Boston, Chicago, New York, Philadelphia, San Francisco, and Washington—six of the biggest U.S. TV markets. Tom Eagan, an analyst at Collins Stewart in New York, says Comcast's major worry will be the lengths it will have to go to avoid court battles. "The big question is the degree of concessions they would have to agree to," he says, to win over the FCC and Justice, both of which declined to comment.

Quoted

"Politically it was the smart thing to do."
—Senator Jim Bunning (R-Ky.), on blocking jobless aid unless it's paid for with new revenues. With polls showing voters increasingly worried about the national debt, other Republicans followed his lead and held up benefits until July 21, when the bill passed 60-40.



Skeptical NBC affiliates, whose views are considered by the FCC in its effort to preserve local broadcasting, were won over when Comcast last month promised not to move the Olympics and major sporting events like *Sunday Night Football* games from broadcast to cable. Comcast also pledged that it would engage in good-faith negotiations with **ABC**, **CBS**, and **Fox** affiliates on carrying their signals. In a bid for minority support, the company said it will name a Latino to its board and add eight independent channels owned by blacks or Hispanics. "Comcast and NBCU have made an unprecedented set of voluntary commitments," Comcast spokeswoman Sena Fitzmaurice said in an e-mail.

Other rivals want even more concessions. Bloomberg, parent of Bloomberg News and *Bloomberg Businessweek*, has told the FCC it wants to ensure its channel will be located near other business shows. Satellite companies **Dish Network** and **DirecTV** are pushing to get the right to arbitration so Comcast can't use its post-merger clout to inflate prices for NBC's programs. Some analysts say the company may have to give up NBC stations in certain major markets to avoid antitrust restrictions. In its home base of Philadelphia, Comcast telecasts games of the city's sports franchises and owns two of them—the 76ers basketball and Flyers hockey teams—as well as Wachovia Center, where both play. For years, Dish and DirecTV have complained that Comcast denied them Philadelphia sports programming. The NBC deal "would enhance Comcast's stranglehold over Philadelphia by adding to its arsenal NBC's owned-and-operated station in that market," Dish told the FCC in a filing.

Comcast should remain flexible about what might be asked of it, says Roger Noll, a senior fellow at the American Antitrust Institute in Washington. The Justice Dept. "is not likely to challenge the deal unless Comcast refuses to make some concessions," he says. ❸
—*Jeff Bliss and Todd Shields*

The bottom line *As federal review of the Comcast-NBC Universal merger goes into high gear, rivals know this is "ask-for" season and seek concessions.*



CEO Brian Roberts is meeting special interests' and rivals' demands

THIS PAGE, FROM TOP: HARRY HAMBURG/AP PHOTO; ANGELA WEISS/GETTY IMAGES
OPPOSITE PAGE FROM TOP: DANIEL ACKER/BLOOMBERG/GETTY IMAGES; BRAD TRENT

Charlie Rose talks to

Timothy Geithner



The Treasury Secretary lays out the parameters of the new financial reform law and gushes about the qualifications of Elizabeth Warren

People ask two things about this legislation. No. 1, will it prevent another crisis? No. 2, does it speak to capital requirements and risk and leverage—the very things that caused the crisis in the first place?
I've always said that the centerpiece of any reform is stronger capital requirements, constraints on leverage, forcing institutions to manage with more stable funding. That is the most important way to prevent future financial crises. What this bill does is provide authority that the government agencies didn't have to make sure we can set and enforce capital requirements, not just on the banks but on large, complicated institutions ... like Goldman Sachs, Morgan Stanley, AIG, GE Capital.

How tough was it to get this through because of the opposition of Wall Street?
There was a lot of opposition and a lot of political opposition from the minority party. But I fundamentally don't understand the basis for the opposition by anybody who looks at what this country went through, what this country is still living with in terms of the scars of the crisis. It brought the economy to the edge of collapse. It caused enormous damage not just to the financial system but to well-managed companies, banks, and investment companies, and to people who were careful and didn't borrow too much. There's no credible way you could look at that system and say we didn't need sweeping reform.

Did it drive a wedge between the President on the one hand and Wall Street and the business community on the other?
There's nothing remarkable in what you're seeing today. Businesses would like to be able to operate with less regulation, fewer constraints, and, of course, lower taxes. But I don't think [the schism] will endure. The President understands that governments don't create jobs.

Let's talk about the consumer aspect of the legislation. How will it be different from what we had before?
What it does is take diffuse authority now spread across a lot of different agencies and put in one place the authority to establish protections for consumers so they'll have much less risk of being caught with a fee they didn't anticipate or being tricked into a loan they can't afford. The singular achievement—and this goes across the bill—is this basic premise: If you're going to be in the business of providing credit and financial services, you need to live under a set of simple rules.

Will Elizabeth Warren be director of the new consumer agency?
Let me just say that she is an incredibly capable, effective advocate for reform. She was way ahead of her time, way ahead of the country in pointing out what was actually happening in the credit business. All the bad stuff that was happening, the looming housing crisis, she was pioneering and pointing out those risks. And she is probably the most effective advocate of reform we have in the country on these questions. So like I say, I think she'd do a great job in that position. But that's the President's decision to make.

The other question is whether her nomination would be approved by the Senate.
Like anybody who has been a champion of reform, she's earned her enemies over time, and there's no doubt she'd face some criticism and opposition up there. But that's the price of entry.

What does Paul Volcker mean when he says this bill took some of the purity out of what he wanted to see.
This is legislation, and there's no risk of excess purity in any legislation. But this is a very strong bill, and it's true to all the things that Paul Volcker and the President said at the beginning were going to be essential. Because what it does is put in place much stronger basic constraints on risk. And he was obviously decisive in helping shape this, explain it, and sell it. What the Volker Rule says is if you own a bank, we don't want you taking advantage of the safety net or the privilege of being a bank and using that to subsidize a bunch of risky activity that could imperil the stability of the system. That's a simple, just constraint. And the bill achieves that.

Fannie Mae and Freddie Mac were not dealt with here.
They're next. We've had a very smart, capable team of people working for six months now looking at alternative ways to reform those institutions and, frankly, fix the broader housing finance market.



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

PHOTOGRAPH ILLUSTRATION BY CREDITTK

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Technology

They Still Believe in Steve

▸ **The market and consumers shrug off "Antenna-gate"**

▸ **"For many people... Apple is what makes them happy"**



$4.8 BILLION

Operating cash generated by Apple in the quarter ended June 30

When **Apple** Chief Executive Officer Steve Jobs announced he was giving away $30 plastic cases to dissatisfied iPhone 4 owners on July 16, Wall Street breathed a sigh of relief. There would be no expensive recall of the more than 3 million reception-challenged devices that had been sold since the iPhone 4's debut on June 24.

Then came Apple's blowout second-quarter results announced on July 20, when the company reported profits of $3.25 billion on $15.7 billion in sales. Analysts were expecting $2.9 billion in earnings on sales of $14.7 billion, according to data compiled by Bloomberg. Judging from the two- to three-week waiting lists to buy an iPhone 4, "Antenna-gate," as Jobs calls it, has not caused Apple-entranced consumers to lose faith. "Let me be very clear on this," Chief Operating Officer Tim Cook said during Apple's earnings call with analysts. "We are selling every unit we can make."

Mac sales also set an all-time record, and the three-month-old iPad sold so briskly that it is already bringing in more revenue than the still-growing iPod business. "For many people in this economy, Apple is what makes them happy," says Kaufman Brothers senior analyst Shaw Wu. "Its products make their lives easier and provide some entertainment, at a time when people don't feel good about a lot of other things in their lives. It sounds silly, but it's not that far from the truth."

Apple's run is far from over, says hedge fund investor David Einhorn of Greenlight Capital, who has been buying shares. "While growth over the next few years will certainly be slower than it has been over the last few years," he wrote in a July 16 letter to investors, "AAPL does not appear to have fully penetrated its market opportunities."

The iPad is selling so briskly that it's already bringing in more revenue than the still-growing iPod business

Of course, it doesn't have those markets to itself. At a time when Apple is racing to ramp up its production capacity, rivals are massing with products of their own. While **Google** recently discontinued its Nexus One phone, mobile phones based on its Android software, such as **Motorola**'s Droid X and **HTC**'s Evo, are selling well. **Microsoft** is about to launch revamped mobile-phone software. Analysts say **Hewlett-Packard** is working on an iPad-like tablet based on technology from newly acquired **Palm**.

Jobs says a primary reason for Apple's success is that it doesn't specialize in software like Microsoft or Google, or hardware like HP or **Samsung**. It does both, enabling it to make minute trade-offs to improve products—say, to get a bit more battery life. It brings the same obsessiveness to its dealings with suppliers and distributors that it does to industrial design. While Apple, like most tech companies, outsources the assembly of its products, it demands to know details down to the source of raw materials, says the CEO of one supplier. It's a cost-effective way of ensuring quality control, says the executive. (Apple spokesman Steve Dowling declined to comment for this story.)

Apple's partners tend to do what they can to keep Cupertino happy: No other tech company can give a supplier or manufacturer the same combination of volume and growth. This gives Apple huge leverage. Mike



Jobs says Apple spent $100 million on its mobile testing facilities

Technology

Fawkes, a venture capitalist who used to be HP's global supply-chain head, says Taiwanese contract manufacturer **Hon Hai Precision Industry** most likely accepts minimal margins on the millions of iPhones and iPads it makes, yet gladly takes Apple's business for the volume and the cachet such an account brings. (Hon Hai spokesman Edmund Ding declined to comment.)

Then there's customer service. Most companies outsource the cost of handholding as much as possible. Apple invests in it, hiring legions of store reps, known as "geniuses," who work at the company's 293 stores. It can afford such investments–the company has $24 billion in cash, and analysts expect it to churn out $10 billion to $15 billion in cash a year from operations.

The one thing Apple can't afford is a real, lasting blow to its stellar reputation. Antenna-gate was not that. Hundreds of people lined up outside for hours when Apple opened a new store in Shanghai on July 10. On the analyst call, COO Cook said U.S. schools, struggling with plummeting budgets, still managed to spend a record amount on Macs. He added that 50 percent of Fortune 100 companies are currently providing the iPad to employees or testing the tablet computer out.

David Eiswert, who manages T. Rowe Price's $271 million Global Technology Fund, says he's less concerned with future product mishaps than with Apple's ability to capitalize whenever the stock market doubts the company's hold on the consumer psyche. He says he has urged Apple to institute an automatic stock buyback program that would be triggered whenever the share price drops. Should there be another Antenna-gate-type screwup, "Everyone would freak out," he says. "And Apple would be able to pick up another 5 percent of the shares at the lower prices." Eiswert says it would be a simple way to improve earnings per share. As if Apple needed any more help.

—*Peter Burrows, with Caroline Dye*

The bottom line *The antenna problems with Apple's iPhone 4 show no signs of dampening consumer demand for the device.*

Engineering

Bad Signal? Don't Blame Antenna Designers

▶ **Apple isn't the only company that's had difficulties with reception**

▶ **"It would be fair to say that antenna design is a little bit of a dark art"**

Whatever you think of Steve Jobs' defense of the iPhone 4 and its reception issues, the **Apple** boss was right about one thing: Antennas are a technological challenge, one that engineers have wrestled with since before Gordon Gekko barked orders into his **Motorola** DynaTAC from a beach in the Hamptons. And as phones continue to shrink, fitting antennas in and making them work correctly often comes down to trial and error, says Stephen Temple, a retired engineer who helped plan Europe's GSM technology. "It would be fair to say that antenna design is a little bit of a dark art," Temple says.

Mobile

A Brief History of the Cell-Phone Antenna

Since cell phones were developed more than three decades ago, antenna design has been one of the thorniest problems handset engineers have faced.
—*Amy Thomson*



Motorola DynaTAC

This 8-in., 2-lb. phone was used to make the first cell-phone call, from a New York street in 1973. Despite its bulk–and the 5-in. rubber antenna that stuck out of the top–the $4,000 DynaTAC became the ultimate accessory for the über-rich after it was featured in the 1987 film *Wall Street*.



Motorola StarTAC

The first smash-hit clamshell phone was introduced in 1996. The StarTAC replaced the DynaTAC's towering antenna with a thin wire whip that could be pushed into the body of the handset.



Nokia 8210

Introduced in 1999, this handset designed by fashion house Kenzo was one of the first cell phones to hide the antenna entirely inside the body. Consumers loved the simplicity of the design and soon began to turn their noses up at phones with external antennas.



Apple iPhone 4

To provide more room inside the case, Apple decided to wrap antennas for its latest phone around the exterior. Problem is, this design innovation put the antennas into contact with callers' fingers, which can block signals. That, in turn, caused Apple's biggest PR flap since the ill-fated Newton handheld.

Quoted

"It's an incredibly talented pony, possibly the most talented pony we've ever seen, but we're waiting for that second trick."
—Internet analyst Jordan Rohan on Google's second-quarter earnings, which fell short of Wall Street estimates



The $4,000 DynaTAC weighed in at almost two pounds and was eight inches long. Today's phones often weigh less than four ounces and can be shorter than the DynaTAC's 5-inch antenna even as they pack in features such as video cameras and QWERTY keyboards. Since the late 1990s, consumer tastes have turned against external antennas, which means they must be crammed inside the handset's casing. Phones now receive different signals such as 3G, Bluetooth, and Wi-Fi, so they often have a half-dozen or more antennas. Reception can be affected by the amount of space around the antenna, the materials used elsewhere in the phone (plastic is less problematic than most metals), and whether the caller is right- or left-handed.

For most of today's basic voice and data cell signals, the right antenna length is about three inches or seven inches. FM radio and broadcast TV antennas are longer, though antennas can be bent to fit inside tiny phones. The optimal length is half the frequency the antenna is designed to receive divided by the speed of light. Any longer or shorter, and the reception can suffer. Furthermore, "the [human] body has a major effect on the antenna because at different frequencies it acts differently," says Stuart Lipoff, an electronics consultant.

The arrival of faster, fourth-generation networks will complicate design further. And as new categories of devices such as the iPad grow in popularity, it's getting harder to design antennas that are appropriate for all their potential uses. In years past, antenna engineers tested phones held against a person's head, says Jeff Shamblin, chief technology officer of **Ethertronics**, a San Diego antenna maker. Now, he says, "you have to test a cell phone sitting on a desk, in a user's lap, [or] being used on speakerphone while operated with two hands."
—Amy Thomson, with Connie Guglielmo

The bottom line *Antenna design has long been a problem for phonemakers, and complexity is growing as devices shrink.*

Internet

Skype Wants the Business of Business

- **The VoIP service hopes Cisco will help it enter the corporate market**
- **"There are some major roadblocks to growing this"**

Skype, which disrupted the telecommunications industry with free or low-cost calls routed over the Internet, is once again an independent company. **EBay** bought the Estonian startup in 2005, but, after a strained relationship, sold most of its stake for $2 billion in November. Now the new owners, led by private equity firm Silver Lake, are imposing business rigor on the company and pushing it to grab a piece of the corporate telecommunications market.

Skype is in talks to sell its software through **Cisco Systems** and **ShoreTel**, both of which make phone systems, according to a person familiar with the discussions. Skype is also doubling the size of its sales and support team to better reach business customers and respond when technical issues arise.

Skype is already a verb for the more than 520 million consumers around the world who use it for phone calls or video chats. According to a report by investment bank Thomas Weisel Partners, Skype had $705 million in revenue last year, a 28 percent jump from 2008. The corporate market, which research firm IDC values at $203 billion, presents a more lucrative opportunity.

Persuading corporations to ditch their traditional carriers won't be easy. "There are some major roadblocks to growing this in the large enterprise space," says Jayanth Angl, an analyst at Info-Tech Research Group in London, Ont. Chief among them: giving IT managers more control. In industries such as health care and finance, companies need to track and monitor calls–something Skype doesn't allow for. Skype also needs to convince potential customers that its service, which is sometimes criticized for poor quality, is reliable and secure enough for important business calls.

To reorient the company, Chief Executive Officer Josh Silverman has replaced five people on his executive staff this year and cracked down on distracting side projects, which had some employees spending their time building 3D chess software. "Skype is serious about providing our business customers the tools and features that put them in control," says David Gurle, who left Thomson Reuters in January to run Skype's business division, where he's doubling head count, to about 100 people.

Skype isn't the only option for companies looking to cut costs by routing calls over the Internet. **AT&T**, **BT Group**, and others already offer Net-based phone systems. Skype is developing an incentive program to encourage ShoreTel and Cisco to recommend its service, possibly by sharing revenues or offering commissions. That may help, but Skype will still need to compete for attention. "Skype is one of" Cisco's relationships, says Mark Monday, a vice-president there who oversees the small business group. "But it's not the only one." *—Joseph Galante*

The bottom line *Skype hopes to work with Cisco and ShoreTel to make inroads into the $203 billion corporate telecommunications market.*

180

Number of digital books sold for every 100 hardcover books on Amazon.com, according to the company

PREVIOUS SPREAD: TONY AVELAR/BLOOMBERG; OPPOSITE PAGE FROM LEFT: TIM BOYLE/BLOOMBERG; SSPL/GETTY IMAGES; NOKIA/BLOOMBERG; COURTESY APPLE

A BBW50 Update

Are Nvidia's Chips Going Stale?

- The stock is off 44 percent after product delays and misfires
- "The new stuff that is out there is really, really good"

Nvidia, a Bloomberg Businessweek 50 company, makes computer graphics chips and expansion cards that help gamers evade realistic zombies and aliens. That hasn't helped the company escape the fusillades of investors. Wall Street has reacted to a string of bad news—postponed product launches, a nasty lawsuit, a bad bet in mobile—by shooting down Nvidia's stock, which is off 44 percent this year, making it the worst performer in the Nasdaq 100.

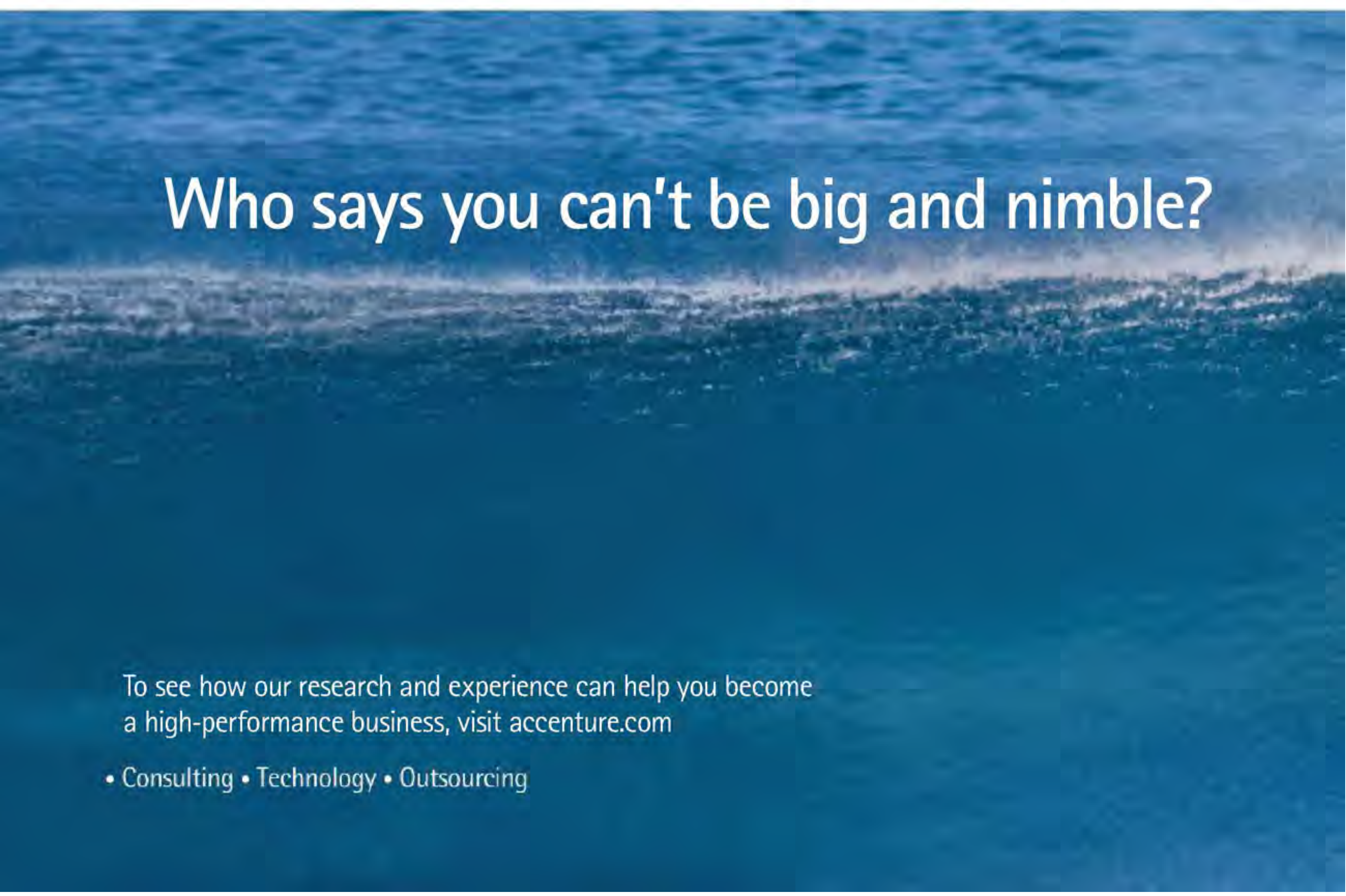
The drop in the company's stock hasn't dented the confidence of Nvidia CEO Jen-Hsun Huang, who says his graphics chips are on the rise. In April the Taiwan-born founder of the company told analysts that the "vast majority of the world" recognizes Nvidia as a "world leader in visual computing." Such statements don't always help him in the eyes of investors, says Hans Mosesmann, an analyst at Raymond James.

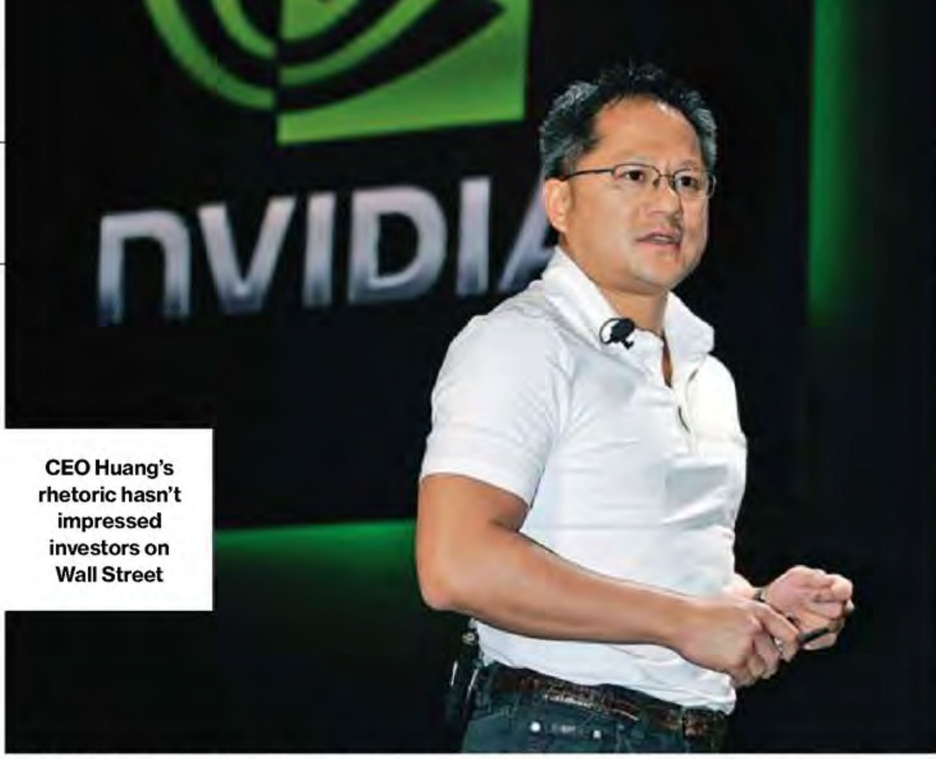
Nvidia's main business is designing high-end computer chips that process the movie-like images in computer games. This year the Santa Clara (Calif.) company introduced Fermi, which promised game designers more processing power. "It's the most forward-looking architecture out there by far," says Dan Vivoli, Nvidia's senior vice-president for marketing. Forward-looking, but not on time: The $200, consumer-oriented version of the chip debuted only last week, six months later than originally planned.

The only major products to use Tegra chips have been Microsoft's Zune player and its discontinued Kin phone

Nvidia also makes components called chipsets, semiconductors that communicate with the computer's central processing unit—i.e., the brain. **Intel**, the largest seller of CPUs, stopped licensing Nvidia's chipsets in February 2009—a move that means Nvidia's chipsets won't work with future Intel CPUs, effectively locking it out of the market. Nvidia sued Intel for breach of contract in March 2009. "The Nvidia decision to exit the chipset business was their business decision, and we have no comment," says Intel spokesman Chuck Mulloy.

Regardless of the outcome of the Intel suit, growth will come not from chipsets, says Chris Caso, an analyst at Susquehanna International. Nvidia's future hinges on chips built for mobile phones and supercomputers—and the company has yet to prove it can successfully compete in those markets.





CEO Huang's rhetoric hasn't impressed investors on Wall Street

MAURICE TSAI/BLOOMBERG

Nvidia's Tegra chip is a case in point. Nvidia designed the chip to function as the brain of smartphones and has touted it as a rival to **Qualcomm**'s Snapdragon, used in **HTC** smartphones, and **Texas Instruments**' OMAP, which powers **Motorola** Droids. To date, the only major products to use Tegra have been **Microsoft**'s Zune music player and its Kin phone, which lasted just six weeks on the market before being discontinued.

Vivoli points out that an updated version of Tegra will appear later this year in phones running **Google**'s Android operating system. Nvidia says it spent too much time fine-tuning Tegra chips so they work with Microsoft products.

Nvidia is also going after chips for supercomputers used in academic research and industries such as oil and gas exploration. It had a victory earlier this year when the Nebulae, a supercomputer in China powered by Nvidia's Tesla chip, was ranked the second-fastest machine in the world. Tesla has yet to make a significant impact on earnings, however.

Despite the string of bad news, Mosesmann sees brighter days ahead. "The new stuff that is out there is really, really good," he says, speaking of the company's new graphics cards. Although exact sales figures aren't available, graphics cards based on Nvidia's new Fermi chip are best-sellers on e-commerce sites popular with gamers such as TigerDirect and Newegg.

While Nvidia may once again be the top choice of the gaming crowd, investors want to see progress in the businesses Nvidia is pushing into, says Susquehanna's Caso. "At this point, because they've focused the Street on Tesla and Tegra, they need to deliver." *—Ian King*

The bottom line *After a spell of product delays and bad bets, Nvidia is counting on the mobile and supercomputer markets for future growth.*



Technology


The rise of black swan insurance page 43 ▶

Counterfeiting

Microsoft Crosses Swords with Pirates

▶ A high-tech lab "fingerprints" discs and traces them to criminals

▶ With no crackdown, "a small break in the dam will become a gusher"

At a crime lab in Dublin, **Microsoft**'s Donal Keating uses a custom-built microscope to take 72 high-resolution images of a counterfeit software disc. Just as police use ballistics to match bullets to a suspect's gun, Keating, the company's senior forensics manager, will use the abrasions and grooves on the stacking ring, a raised ridge around the disc's center, to match it to other fakes. He'll then try to trace the counterfeit disc to the factory and the crime syndicate that produced it.

The high-tech probing is part of a campaign by the world's largest software maker to vanquish counterfeiters. Microsoft employs 75 investigators, lawyers, and analysts—many with experience in narcotics and Mafia cases—in nine labs around the world. They're armed with maps that help pinpoint where suspect products are bought or seized by law enforcement, software that identifies digital fingerprints on discs, and a program that scours the Web for downloadable fakes.

Counterfeiting probably costs the software industry about $10 billion a year in lost revenue, says John Gantz, an analyst at IDC who puts together an annual report on worldwide piracy. Microsoft facsimiles likely represent the biggest piece of that, he says.

Once Microsoft has gathered evidence about where fakes are coming from, it alerts local law enforcement. In 2007 the company helped Chinese authorities break up a syndicate that had generated $2 billion in counterfeit Microsoft products. In December the company helped Indian police raid one of that country's largest resellers of Microsoft products, which was pairing legitimate goods with knockoffs to boost profits.

David Finn, Microsoft's associate general counsel for antipiracy, set up the unit in 2000, shortly after the company lost what it expected to be a straightforward counterfeiting case in England. The judge said Microsoft hadn't provided enough evidence to prove that software discs were fake. Finn, who had prosecuted terrorists and drug lords in the U.S. attorney's office, realized the company didn't know enough about collecting and presenting evidence for a criminal case. "This is a large-scale criminal gang syndicate problem, and Microsoft's conventional legal resources were not going to be able to meet the challenge," says Finn.

Ballistics matching can be done only on a special microscope in the Dublin crime lab—a problem in jurisdictions that require criminal evidence to stay in country. So Microsoft has started using a newer method of tracking discs that requires a standard computer, a CD drive, and some software. The technique involves identifying digital traces left behind by the laser that stamped the disc.

Increasingly, pirated software is downloaded from the Internet, so the unit also uses software that scans the Web looking for illicit Microsoft products. Three weeks ago the team found a site that offered to convert free trials of Office 2010 into full versions. Microsoft found it contained malicious code that could harm computers, according to Peter Anaman, online piracy senior program manager at Microsoft. The software has been removed.

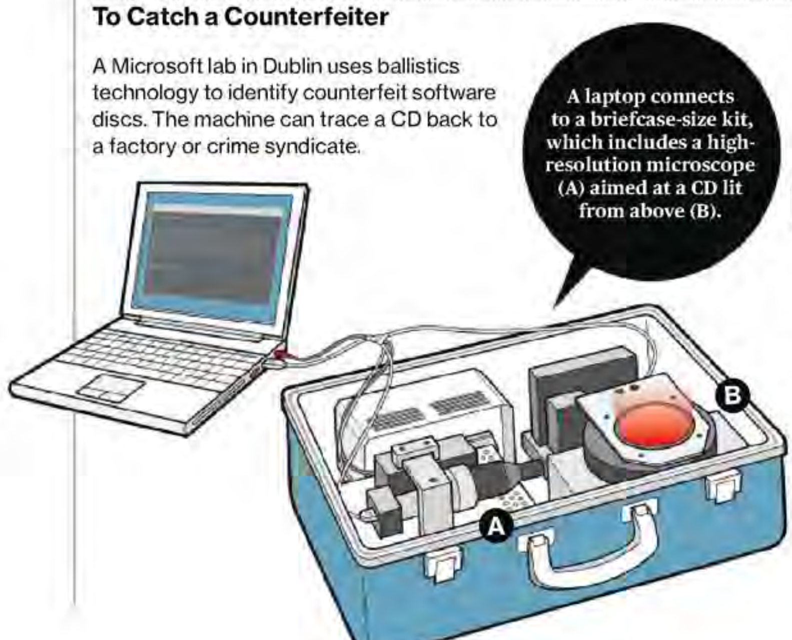
While successful prosecutions hobble organized crime syndicates temporarily, many of the gangs come back or are replaced by newcomers. Microsoft officials believe the Chinese syndicate busted in 2007 has already reemerged. "Once you crack down on one group, it can crop up elsewhere," says Robert Holleyman, chief executive officer of the Business Software Alliance, a trade group. "But you need to crack down—otherwise a small break in the dam will become a gusher."

—*Dina Bass*

The bottom line *Microsoft employs digital forensics and other technologies to help law-enforcement authorities bust counterfeiter syndicates.*

To Catch a Counterfeiter

A Microsoft lab in Dublin uses ballistics technology to identify counterfeit software discs. The machine can trace a CD back to a factory or crime syndicate.





Magnifying

The microscope zooms in on the outer edge of the stacking ring, a raised ridge around the disc's center meant to keep stacked CDs from scratching each other.

Photographing

As the disc spins, the machine snaps 72 high-resolution pictures of the stacking ring. They reveal grooves and blemishes created during manufacturing.

Identification

Software analyzes the grooves, which are unique to the mold used to make the CDs. That helps investigators trace the disc to its origin.

Computers

IBM Mainframes: Boring But Profitable

▶ The bulky, powerful machines are still a high-margin business

▶ IBM "tends to sell IT software products" around mainframes

Under its Chief Executive Officer Sam Palmisano, **IBM** has expanded relentlessly into lucrative realms such as computer services and software. So mainframe computers would seem as outdated as punch cards. Not so. True, these big computers bring in only about $3.4 billion a year in sales, on average, less than 4 percent of Big Blue's total revenue, analysts estimate. Still, mainframes are a high-margin business and generate additional software and service revenues that IBM covets.

In September, the Armonk (N.Y.) company will start selling the zEnterprise, its latest model, which starts at about $1 million. Lou Miscioscia, an analyst for Collins Stewart, estimates the machines carry profit margins of about 70 percent, vs. a 46 percent margin for the company as a whole. (IBM doesn't disclose mainframe sales or profits.)

IBM "tends to sell additional IT software products and services around the mainframe," says Chris Whitmore, an analyst at Deutsche Bank. When IBM introduced each of its last five mainframes, sales in Big Blue's services division jumped by an average of 3 percent in the following two quarters, according to an analysis by Whitmore. If the 2008 update, which came during the credit crunch, is excluded, the boost is 9 percent.

Most mainframe purchasers are big companies in data-intensive industries such as finance and insurance. With the zEnterprise line, which IBM says is easier to maintain and more energy-efficient than past models, the company is trying to reach out to new customers, especially in developing markets. These big machines may not be IBM's most glamorous business, but they're a critically important one. Ⓑ —*Katie Hoffmann*

The bottom line *Big Iron, which represents only 4 percent of IBM's revenues, helps the company sell additional software and services.*

Innovator

Marissa Evans



The former marketer started Go Try It On, a website that uses instant online feedback to help solve a daily dilemma: What to wear?

The wisdom of online crowds has helped people make a lot of decisions, like what restaurant to try (visit Yelp's amateur reviews) or band to listen to (go to OurStage). Marissa Evans is bringing crowdsourcing to another daily dilemma: what to wear. Last year the 26-year-old Harvard Business School graduate quit her job at a digital marketing firm and began working full-time on Go Try It On, a New York-based website that allows users to post photos of themselves on the site and get fast feedback about their outfits from the masses. "I live alone now," says Evans. "I thought there should be a way to leverage technology to get this advice quickly."

Go Try It On, which debuted in March, attracts about 50,000 unique visitors per month. Users upload their photos, usually cropped at the neck or with the face blurred, and append a brief message about their intentions for the outfit. ("Company party with white theme," wrote Sasha H.) Others then vote it up or down and leave comments. Ideally, the user gets a near-instant verdict from unbiased observers. The site awards virtual "fashionista" badges to the most helpful advice-givers.

There are other sites, including StyleDiary and Fashism, that let people share photos of clothes, but they are more geared to the fashion-obsessed. Go Try It On's goal is to bring speedy help to a larger audience–"anyone who has to get dressed in the morning," says Evans. About 80 percent of the site's photos come from women.

Evans is funding her company with investments from friends and family. The challenge will be to attract enough users willing to offer advice on short notice. She says she's planning to release an iPhone application to bring the service into store dressing rooms. A staff of 10 monitor the site to keep it free of snarky comments and inappropriate photos. "I've been really proud of the quality," she says.

Joydeep Dey, who works in advertising for Google in New York, says he visits Go Try It On daily to vote on other people's outfits and uploads his own photo once every couple of weeks. He recently tried out a pair of red Tretorn rain boots that he thought looked "great." His peers on Go Try It On disagreed. The boots "went on eBay really quickly," Dey says.

The next challenge for Evans: Make money. She wants to sell ads, and hopes to take advantage of links to products inserted by some commenters. The plan is to persuade stores and designers to pay a commission when users follow those links and make a purchase. She also envisions sponsored events such as a "Macy's go-try-on-a-little-black-dress" contest.

When this reporter tried the site to pick a tie, one response came back in 40 minutes before I left for work. By midday, 60 voters chimed in and voted for a solid-color tie over a floral alternative. Commenters didn't hold back; one called my look "old mannish." Ⓑ —*Ira Boudway*

Background ▶ **Grew up near Boston; MBA from Harvard**

Target customer ▶ **"Anyone who has to get dressed in the morning"**

Business plan ▶ **Ads, sales commissions, corporate-sponsored events**

CLOCKWISE FROM TOP RIGHT: PHOTOGRAPH BY ETHAN HILL FOR BLOOMBERG BUSINESSWEEK; ILLUSTRATION BY KATE FRANCIS; VANDERLEI ALMEIDA/AFP/GETTY IMAGES

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The Rush to Hedge Against Black Swan Events

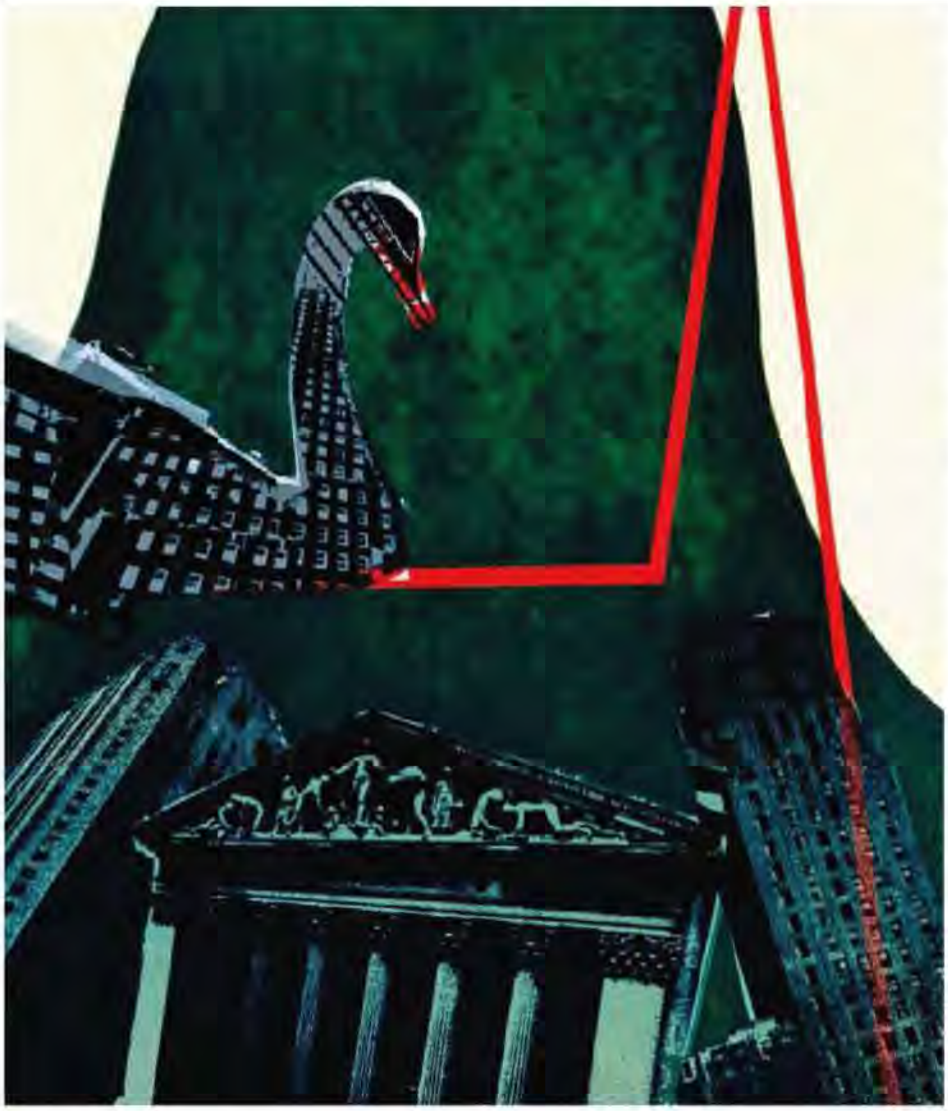


ILLUSTRATION BY KATE BAZAZI

▶ A boom in funds that offer protection from market calamities

▶ "Now it just seems brilliantly misguided," says a skeptic

Wall Street's hottest new product is fear. **Pimco**, **Deutsche Bank**, and **Citigroup** are among firms offering clients protection against "long-tail" risks—extreme market moves that Wall Street's financial models fail to anticipate. In what Morgan Stanley strategists say is an indication that more investors are seeking insurance against financial turbulence, they estimate there was as much as a fivefold increase last quarter in trading of credit derivatives that speculate on market volatility.

The growing interest in catastrophe insurance shows that investors still haven't recovered from the Lehman Brothers bankruptcy on Sept. 15, 2008, which erased $20.3 trillion in stock market value worldwide and caused credit markets to freeze. Recent events such as the May 6 stock market rout that briefly sent the Dow Jones industrial average down almost 1,000 points have added to the anxiety.

High unemployment, housing woes, and slow growth in the U.S. continue to keep the markets unsettled. "Everyone is starting to realize that this is going to be a much longer, much more difficult path to recovery," says William Cunningham, head of credit strategies and fixed-income research at State Street's investment unit in Boston, which oversees almost $2 trillion. "It's really quite fragile and vulnerable in a way that we haven't seen in our lifetime."

The term long-tail risk is derived from the outlying points on bell-shaped curves that forecasters use to plot the probability of losses or gains in a given market. The most probable outcomes lie at the center. The least probable, such as a decline of 5 percent in an index that most days rises or falls by less than 0.25 percent, are plotted at the "tail," or the end of the curve. The greater the deviation, the longer the tail.

Before the 2008 financial crisis, author Nassim Nicholas Taleb warned bankers that they relied too much on probability models and had become blind to potential cataclysms, which he labeled black swans. That's a reference to the widely held belief that only white swans existed—that is, until black ones were discovered in Australia in 1697. His 2007 book, *The Black Swan*, contends tail risks are becoming more severe.

The increasing frequency of events that fall on the fringes of probability is prompting pension fund managers and other institutional investors, who once shunned costly hedging strategies, to reconsider. The Indiana Public Employees' Retirement Fund, which manages $14.1 billion, asked financial institutions in January to send information on a tail-risk management program that would protect it against "an extreme market downturn."

"People are trying to move



Inside the labs at Consumer Reports page 58 ►

beyond historic notions that tail-risk events are so infrequent on the one hand, and so extreme on the other hand, that there is nothing you can do about them," says Eugene A. Ludwig, who started Washington-based risk management firm Promontory Financial Group after serving as U.S. Comptroller of the Currency under former President Bill Clinton.

Pimco Chief Executive Officer Mohamed A. El-Erian developed tail-risk strategies when he was manager of Harvard University's endowment in 2006 and 2007. Pimco, which manages about $1.1 trillion, opened its first mutual fund aimed at minimizing risks from systemic shocks in October 2008. The **Pimco Global Multi-Asset Fund**, co-managed by El-Erian and Vineer Bhansali, had about 7 percent of its $2.1 billion in assets invested in the SPDR Gold Trust as of Mar. 31. It also held put options, including some on S&P 500 index futures that would pay off if the benchmark fell below 700 by December. Pimco is using tail-risk strategies in many of its funds, says Bhansali. "You don't want to try to be too smart in trying to forecast what is going to happen and which hedge is going to perform better," he says. "What you want to do is accumulate cheap protection."

Deutsche Bank is marketing a tail-risk hedging index that gains in value when a gauge of stock-market volatility increases, according to material the bank sent to clients. The so-called **Equity Long Volatility Investment Strategy**, or ELVIS, uses derivatives called variance swaps linked to the Standard & Poor's 500-stock index. These swaps increase in value when market turmoil hits and are designed to provide some insurance against a cataclysmic selloff.

Demand for such trading strategies prompted Citigroup to hire John Liu, a former employee of the Indiana pension fund, about two months ago to advise pension plans, endowments, and foundations on tail-risk hedging, according to a prospective investor who declined to be named because the hire hasn't been publicly announced.

Other asset management firms that hedge against Armageddon events in the market are creating funds to take advantage of demand. **Pine River Capital Management**, a Minnetonka (Minn.) firm with $2.1 billion under management, started the Nisswa Tail Hedge Fund last month, according to a June 15 filing with the Securities & Exchange Commission. The partnership was formed at the request of investors who wanted access to the hedging techniques used by Pine River's primary multistrategy fund, which gained 40 percent during 2008 and 2009, according to co-founder Aaron Yeary.

Still, investors should be wary of long-tail hedging products, says Eric Petroff, director of research at Wurts & Associates, a Seattle-based consulting firm that oversees about $30 billion on behalf of institutional investors. "Products that protect you from tail risk tend to crop up after the tail has occurred," he says. "Back in 2007 it made a lot of sense to hedge tail risk—but now it just seems brilliantly misguided."

Taleb set up tail-risk hedge fund Empirica in 1999 and ran it for six years. He thinks the hedging strategies are a Wall Street fad that won't last. Big payouts from long-tail insurance will be so infrequent that most money mangers will lose interest. "They will drop like flies," says Taleb, now a professor at New York University's Polytechnic Institute. "They and their customers will give up at some point. I've seen it before." *—Shannon D. Harrington, Miles Weiss, and Sree Bhaktavatsalam*

The bottom line *The financial upheavals of the past few years have persuaded many big investors to buy protection against market meltdowns.*

0.5520

PERCENT

The yield the two-year Treasury note fell to on July 21, a record low

DATA: BLOOMBERG

Bankers

'Pirate Pete' Says Steer Clear of Bank Stocks

► The ex-risk officer decries Cameron's "popular capitalism"

► "The idea of encouraging people to invest ... is risky"

Gordon Dickson learned something during his transformation from Bank of Scotland risk officer to "Pirate Pete," an eyepatch-wearing children's entertainer: Don't invest in banks.

The 62-year-old Glaswegian, also known as "Mr. Giggles," lost a million pounds ($1.5 million) when the bank shares he'd bought over three decades collapsed during the financial crisis. Now he advises fellow Britons to shun the proposed sale of taxpayer-owned shares in **Royal Bank of Scotland Group** and **Lloyds Banking Group**, dubbed the People's Bank Bonus by the Conservative-led government. "I wouldn't buy bank shares at the moment," he says in an interview at his suburban home in Renfrew, Scotland. Other people should also steer clear because share values won't rise "for a long, long time."

Britain's new coalition government said in June that it plans to sell the bank shares to the public at a discount to foster what Prime Minister David Cameron termed "popular capitalism." Government figures show that the portion of all publicly traded shares held by individuals fell to a record low of 10 percent at the end of 2008 from about 20 percent in 1990, Margaret Thatcher's last year as Prime Minister.

The credit crisis inflicted pain on British bank investors in two ways. Share values plunged, with the FTSE 350 Index of Britain's biggest banks losing approximately $322 billion of market value between its February 2007 peak and March 2009. Also, banks including Lloyds and RBS halted dividend payments in 2008 and have not yet resumed them. "Banks as we have found over the last few years are very volatile investments," says Colin Morton, a fund manager at Rensburg Fund Management in Leeds, England. "The idea of encouraging people to invest in one bank, even at a discount, is very risky."

OPPOSITE PAGE: MICK MCGURK/CENTRE PRESS AGENCY

Dickson suffered months of depression and an end to his early retirement as dividends dried up during the crisis. He turned to "Pete the Pirate," a children's party character he'd created as a hobby, as a way out of his financial bind. "I am ashamed to be known as a banker. I am much happier being known as 'Pete the Pirate,'" says Dickson, a married father of two whose home is filled with pictures of his daughters. "I think the people at the top tiers of management today could be described as pirates."

$322 BILLION

Market value lost by big U.K. banks from February 2007 to March 2009

Dickson joined Bank of Scotland in 1965 right after he left school. He ended his career as a senior risk officer a year before the bank's merger with Halifax Building Society created HBOS in 2001. The combined entity came close to collapse in 2008 and was taken over by Lloyds. Dickson says he is still in shock at the disappearance of HBOS. In part, that's because its predecessor, Bank of Scotland, was founded in 1695 and survived every previous crisis, including the occupation of Edinburgh by Bonnie Prince Charlie's army in 1745, when it was forced to close its doors temporarily.

The pirate says he enjoys his new career. He charges about $300 per event and sometimes works seven days a week. He's been hired to perform at a range of occasions, including this month's Scottish Open golf tournament at Loch Lomond, where he entertained the players' children with magic tricks, puppet shows, games, and dancing.

The government has about $109 billion invested in bank stock after rescuing RBS, Lloyds, and **Northern Rock** during the financial crisis. In return for taxpayer support, Britons "would have the chance to buy shares in the state-owned banks at a discounted price," the Conservatives said in February. "Special offers would encourage younger people and those on modest incomes."

The public sale would be one way for the government's 83 percent stake in RBS and 41 percent holding in Lloyds to be returned to private ownership. There is no timetable for the sales. Opposition Labour party politicians have attacked the People's Bonus policy as a gimmick, warning that the plan offers a poor return to taxpayers and describing it as an attempt to buy votes.

Dickson acknowledges that as a risk officer he should have known to spread his investments across more sectors. "A lot of it was my own fault, having so much trust and faith in the organization and not realizing life had moved on," says Dickson. "In my wildest dreams I could not imagine that this could have happened." —*Andrew MacAskill*

The bottom line *Dickson says others should not repeat the mistake he made in assuming bank stocks were safe investments.*



"The top tiers of management today could be described as pirates"

Investing

Cash-Rich Companies Are Raising Dividends

- **Philip Morris and News Corp. may boost payouts in coming months**

- **Russell 3000 dividend changes**



Companies that hoarded cash during the recession and financial crisis are giving a bit more back to shareholders. About 15 percent of the companies in the Russell 3000 index, which includes the 3,000 largest publicly traded U.S. companies, raised their dividends last quarter, double the percentage a year ago. And the trend will continue, according to Bloomberg's latest dividend forecast, with 14 percent of Russell 3000 companies likely to boost their payouts during the next three months, up from 9.7 percent in the same period last year.

In the aftermath of the global economic collapse, "there was real uncertainty and fear, and even companies with tens of billions of cash were unwilling to do much with it," says Kennard Allen, manager of T. Rowe Price's Science & Technology fund. "Companies have felt better about their business in the last couple of quarters."

Russell 3000 index companies have $2.9 trillion in cash and short-term investments, 19 percent more than the year before, according to the latest quarterly data compiled by Bloomberg. "Companies have so much [cash], and they're looking for different ways to put it back to work," says Walter Todd, who helps manage $800 million at Greenwood Capital.

The trend is even playing out in the tech sector, not generally known for lush yields. **IBM** announced a dividend boost of 18 percent in April, almost doubling last year's increase. Chipmaker **Analog Devices** also had an 18 percent hike. Looking ahead, **Philip Morris International** may lift its dividend 10 percent this quarter, according to the Bloomberg forecast, which

is based on seven criteria, including a company's guidance and dividend history. The Bloomberg analysis also suggests that **News Corp.**, owner of *The Wall Street Journal*, will increase its dividend 20 percent in the quarter, while **Virgin Media** and cruise ship operator **Carnival** will lift their payouts by 50 percent.

Todd recommends dividend-paying stocks to investors as a way of earning yields similar to Treasuries, with the bonus of a potential appreciation in share price. Bloomberg forecasts that yields for utilities, financial, and communications stocks will be more than 3.78 percent this quarter. Technology, consumer, basic materials, and industrial companies are likely to pay more than 2 percent. Yields on the benchmark 10-year Treasury note are below 3 percent. "You've got dozens of large-cap names with dividend yields in excess of Treasuries," says Todd. "To me it just makes a lot of sense to use some of these names as substitutes for fixed income."

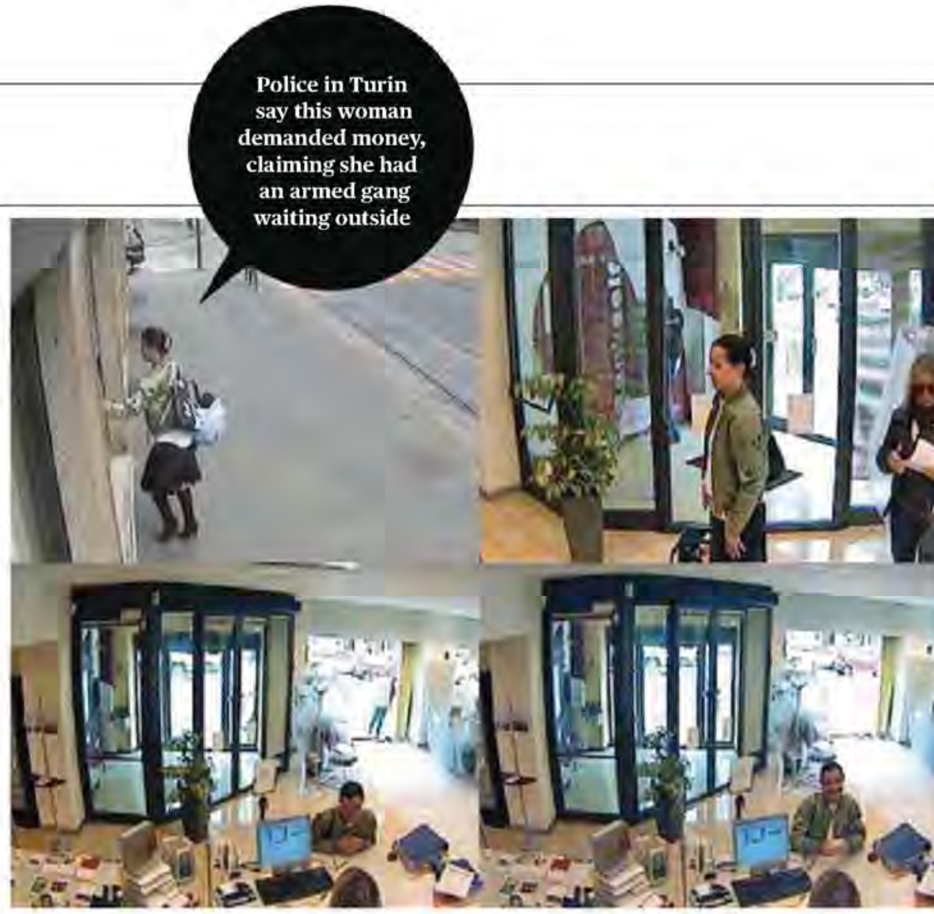
Bahl & Gaynor Investment Counsel, which has $2.7 billion under management, invests only in dividend-paying stocks. "Dividends are and have been a crucial part of the stock market's total return," says Matt McCormick, a portfolio manager at the firm. "The way people are starting to pay attention to them," says McCormick, "it's almost like they're discovering one of the lost gospels." —*Mark Clothier*

The bottom line *With growing amounts of cash on hand, companies are increasing dividends to return money to shareholders.*

Crime

Italy Sets the Pace in Bank Robberies

- The country accounts for more than half of Europe's heists
- "I didn't know how to get by with a small child," says one thief



Italy's biggest banks rank no higher than ninth in Europe by market value. They come in first by another yardstick: robberies. Italy recorded 1,744 bank robberies last year, more than six times the number in Germany and 20 times the U.K. figure, according to a June 30 report by FIBA, the Italian bank employees' union. The country's banks lost $47.5 million to thieves last year, according to data compiled by Italian banking association ABI. Bank robberies in Italy accounted for almost half of such thefts in the European Union last year.

Most Italian bank robberies are small-time jobs, with two out of three heists bringing in less than $20,000, according to ABI. Many of the perpetrators are amateurs, often armed with little more than knives. A 41-year-old mother robbed three banks in the Turin area in one day in May with her seven-month-old baby in tow. "I haven't got a steady job," she told police when she was arrested after her fourth attempted holdup of the day. "I didn't know how to get by with a small child." Police have declined to disclose her identity.

Italian banks spend more than $900 million a year on antitheft equipment such as closed-circuit cameras and alarms, says Alessandro Spaggiari, FIBA's national secretary in Rome. He adds that only a little of that money goes to smaller branches, since those locations have relatively limited amounts of cash. The abundance of branches in neighborhoods with minimal police presence makes Italian banks easy pickings. **Intesa Sanpaolo**, Italy's biggest bank by branches, has 5,921 outlets in its home market, more than twice as many as France's **BNP Paribas** and about 1,000 more than **Banco Santander** has in its Spanish network.

The ABI is trying to get Italians, who like using cash, to switch to credit cards and other noncash instruments to improve security and bring Italy in line with the rest of Europe. Italians make an average of 66 noncash transactions per person every year, about one-third the euro zone average and four times less than in Britain, according to a Bank of Italy report. Says Pierfrancesco Gaggi, head of infrastructure at ABI: "The less that cash circulates in branches, the fewer robberies we'll have."
—*Sonia Sirletti and Flavia Rotondi*

The bottom line *Italy's abundance of bank branches in areas with low police presence means robbers have plenty of potential targets.*

Quoted

"I, for one, am more or less willing to throw in the towel on behalf of inflation. ... Even if we get intermittently rising commodity prices ... the downward pressure on prices from weak wages and weak demand seems to me now to be much the larger factor."
—Jeremy Grantham, chief investment strategist, money management firm GMO



FROM TOP: CRONACAQUI/CARABINIERI DI TORINO (4); JODI HILTON/THE NEW YORK TIMES/REDUX



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Earnings

Bank Profits Are Worse Than They Look

- Two accounting adjustments made the bottom line bigger
- "I've always called that ink on paper," says Dimon

Four of the six largest U.S. banks posted profit declines in the second quarter. **Goldman Sachs** had the biggest drop–82 percent–partly because of a wrong bet that markets would become less volatile. Goldman also had to pay $550 million to settle claims by U.S. regulators that it misled investors when creating securities linked to subprime mortgages.

Results for the big banks would have been worse without a pair of accounting adjustments worth a total of $8 billion of additional revenue: a reduction in money set aside for bad loans and gains resulting, paradoxically, from the lower market value of the firms' own bonds.

Bank of America, **JPMorgan Chase**, and **Citigroup** booked gains of about $1.5 billion each by reclaiming money they had set aside to cover loan losses; they did so at least partly based on changes in internal estimates of future defaults. At Bank of America, the largest U.S. bank, the change accounted for 38 percent of pretax income. The share was 21 percent at JPMorgan, the second-biggest bank, where Chief Executive Officer Jamie Dimon urged investors to discount the gain. While a reduction in estimated loan losses is good, "we don't consider that earnings," Dimon told analysts on July 15. "I've always called that ink on paper. It means nothing, O.K.?"

The six banks, which also include **Morgan Stanley** and **Wells Fargo**, booked more than $3 billion of "debt valuation adjustments," or DVAs, based on an accounting rule adopted in 2007 that lets them mark their own bonds to market value. The rules reflect the possibility that they could buy back their debt at a discount–something they rarely do. At Morgan Stanley, DVAs added $750 million to revenue, accounting for 45 percent of pretax income.

Such gains helped mask a decline in the earnings that matter–interest income, or the difference between the interest a bank collects and what it pays out. Bank of America's interest income fell by 6.2 percent from the first quarter, to $12.9 billion, as its loan book shrank by 2 percent. Fewer consumers are choosing to add to their debt loads, so "core revenue growth is difficult," Bank of America CEO Brian T. Moynihan told investors on July 16. —*Bradley Keoun*

The bottom line *Accounting adjustments are making bank earnings look better, even as a sluggish economy makes it hard to increase lending.*

Accounting for earnings

Loan loss and bond adjustments boosted big bank profits this quarter.



DATA: COMPANY REPORTS

Drawing Board



Wall Street

Capitol Gridlock Could Spark a Stock Surge

- Republican control of the House could be bullish for stocks
- The S&P 500 rose 6.7 percent in the year after the 2006 elections

President Barack Obama has already presided over the biggest stock-market rally during the start of a Presidency since Franklin D. Roosevelt in the 1930s. Now, if election year history is any guide, stocks are poised for further gains, though for reasons Obama probably wouldn't like. Should Democratics fare poorly in this fall's midterm elections and lose control of the House to Republicans, stock investors could view the resulting split government as a positive.

"Markets love gridlock," says Ken Fisher, who oversees $35 billion in Woodside, Calif., as chief executive officer of Fisher Investments. "What the markets want to see is no change: less legislation that engages in changes in taxes, spending, regulation, or property rights." The billionaire Fisher expects the market to stage a rally even before the midterm elections. Bets made on **Intrade**, a Dublin-based prediction market, show a 54 percent chance Re-

THIS PAGE: ILLUSTRATION BY WALT HANDELSMAN/NEWSDAY. OPPOSITE PAGE, CLOCKWISE FROM TOP LEFT: JEMAL COUNTESS/GETTY IMAGES; SSPL/GETTY IMAGES; SOTHEBY'S/BLOOMBERG; ERIC BEAN/THE IMAGE BANK/GETTY IMAGES

publicans will take the House.

How big are the potential stock-market gains? The Standard & Poor's 500-stock index has advanced 15 percent on average in years when there was a Democratic President and Republican majority in Congress, the most of any combination, according to New York-based **Strategas Research Partners.**

The S&P 500 gained 6.7 percent in the 12 months after the 2006 midterm election, when Republicans and President George W. Bush lost control of both houses. In the 1994 congressional elections under President Bill Clinton, Democrats gave up their majority in the House and Senate. That was followed by the S&P's 34 percent surge in 1995, the biggest in 37 years, data compiled by Bloomberg show. The chance that Democrats will lose their Senate majority this year is 18 percent, according to Intrade.

The stock-market gains are even more impressive in the second year of a Presidency when viewed from a trough-to-peak perspective. The S&P 500 index has surged 48 percent on average starting in the second year of each U.S. Presidential term, measured from its lowest level that year through the high in the third one, according to data compiled by Bloomberg that goes back to 1928. That compares with trough-to-peak gains of 38 percent in other years.

Midterm election cycles aside, many other factors will affect the market. Corporate earnings are key, and the outlook is good. S&P 500 companies are projected to increase profits 34 percent in 2010 and 17 percent in 2011, the fastest two-year gain since 1995, based on analysts' estimates.

On the flip side, America's record budget deficits are a negative for stocks. "The U.S. is going to have to deal with its debt issues, so we see that as a constant wall that the market and economy are going to have to slowly find their way through," says Jason Pride, director of investment strategy at Glenmede, whose Philadelphia-based firm manages $18 billion. "I don't think you should make an entire investment decision on the Presidential cycle."

—Kelly Bit and Lynn Thomasson

The bottom line *Investors seem to like gridlock: Stocks do best when there's a Democrat in the White House and a Republican majority in Congress.*

Bid & Ask

by Cristina Lindblad



Memorabilia

It's not often that you see a stuffed animal priced in the six digits. Trigger, the golden Palomino that was Roy Rogers' sidekick, fetched **$266,500** at a Christie's auction in New York. The buyer was Patrick Gottsch, founder of RFD-TV, a TV network aimed at rural America. Gottsch also paid $35,000 for Rogers' German shepherd, Bullet.

Airlines

$9.1 bn

Emirates announced an order for 30 Boeing 777-300ER aircraft at the Farnborough International Airshow. The Arab world's largest carrier is racing to expand its fleet of long-range jets as part of a plan to boost Dubai as a global air hub. Last month it ordered 32 A380 superjumbos from Airbus.

Private Equity

In a **$6.7 billion** shopping spree at the end of July, Washington-based buyout firm Carlyle Group announced three deals over five days. Here's the itemized receipt: **$3.8 billion** for NBTY, a Ronkonkoma (N.Y.)-based maker of vitamins and health supplements; **$1.2 billion** for Brazilian health-care company Grupo Qualicorp; and, together with TPG, **$1.7 billion** for Australian hospital chain Healthscope.

Personal Care

London-based Candover Partners is selling Belgian diaper maker Ontex for **$1.6 billion** to TPG and Goldman Sachs Group's private equity arm. Hard hit by the credit crunch, Candover shut down its leveraged buyout fund in January amid a cash shortage and is in the midst of negotiations to sell itself to a Canadian pension fund.



Pharmaceuticals

GlaxoSmithKline has agreed to pay over **$1 billion** to resolve more than 800 cases alleging that its Paxil antidepressant caused birth defects in some users' children, according to people familiar with the settlements. That works out to an average of $1.2 million per family. Some 100 cases are still outstanding. The drugmaker has set aside $2.4 billion to resolve litigation over Paxil and its Avandia diabetes drug, which allegedly poses increased risks of heart attacks and strokes.



Health

Reckitt Benckiser is buying condom maker SSL International for **$3.9 billion.** Reckitt, a maker of household cleaners and over-the-counter drugs, is on a hunt for new sources of revenue because its fastest-growing product, heroin addiction drug Suboxone, will soon face competition from generic versions.

$7.0 bn

Oil

BP, the British oil major battling a record oil spill in the Gulf of Mexico, agreed to sell assets worth $7 billion in North America and Egypt to Apache. BP has said it will sell some **$10 billion** of assets over 12 months to fund compensation for damages from the accident.

Telecoms

Nokia Siemens Networks, the world's second-largest maker of wireless phone systems, is spending **$1.2 billion** to buy wireless network assets from Motorola. The deal will give the Finnish-German joint venture a bigger foothold in North America and Japan. Motorola is selling the business as part of a breakup plan that will see the struggling Schaumburg (Ill.)-based company spin off its mobile-phone and set-top box operations into a separate company.



Wines

Four magnums of Château Latour from the Bordeaux producer's historic 1961 vintage fetched **$52,426** at a Sotheby's auction of fine wines in London. The 1961 Latour rates a perfect 100-point score from American wine critic Robert Parker.



Lured by the idea of profiting from raw materials, investors put $277 billion into commodity ETFs and related securities by the end of 2009. Then they noticed a problem: When commodities go up, the commodity ETFs often don't.

By Peter Robison, Asjylyn Loder, and Alan Bjerga

Typography by Alexis Mackenzie



Like so many investors in the spring of 2009, Gordon Wolf needed to dig out of a hole. A 68-year-old psychologist in Napa, Calif., Wolf was a buy-and-hold sort of guy, yet the nest egg he had entrusted to his broker at Merrill Lynch was suddenly down by more than 50 percent. The broker had invested much of it in a range of exchange-traded funds, or ETFs, a relatively new financial innovation that was replacing mutual funds in the hearts and portfolios of many investors.

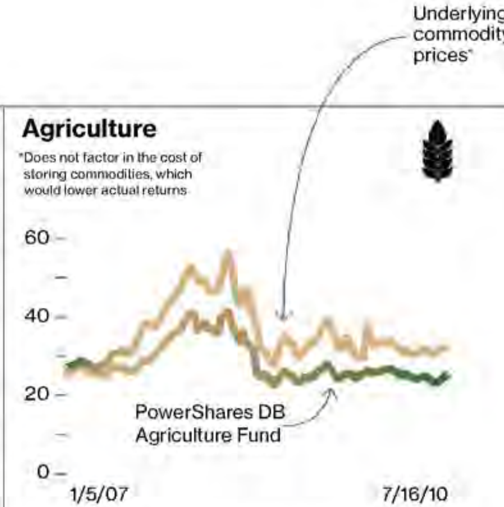
An ETF, which can be bought or sold like a stock, attempts to track the price of a particular basket of assets—tech stocks, for instance, or high-yield bonds, or commodities ranging from wheat to gold to oil to natural gas. The commodity ETFs were supposed to offer a hedge against equity losses, but in the crash of 2008 everything fell in tandem. Now it was early 2009, and Wolf was watching oil fall to $34 a barrel. That had to be an opportunity, he figured, so he called his Merrill broker and asked about the U.S. Oil Fund, an ETF designed to track the price of light, sweet crude. “This seems to be something good,” Wolf told the broker, and had him buy about $10,000 of USO.

What happened next didn’t make sense. Wolf watched oil go up as predicted, yet USO kept going down. In February 2009, for example, crude rose 7.4 percent while USO fell by 7.4 percent. What was going on? Wolf logged on to Seeking Alpha, a financial blog, and searched for USO. He found plenty of angry discussion about the fund—lots of people were losing lots of money, because thousands of American investors had seen the same sort of opportunity Wolf had. By the end of 2009, they had a record $277 billion invested in commodity ETFs and other securities linked to raw materials—a 50-fold jump from $5.5 billion a decade earlier, according to Barclays Capital. During that time, Wall Street had transformed the reputation of commodities from a hyper-volatile investment that can steal your shirt to a booster for battered portfolios, something that rose when stocks fell and hedged against inflation. People who would never think of buying a tanker of crude or a silo of wheat could now put both commodities in their 401(k)s. Suddenly everybody was a speculator.

And some were losing big. The commodity ETFs weren’t living up to their hype, and the reason had to do with a word Wolf had never heard before. As he browsed the blogs, he says, “I’m seeing people talking about something called *contango*. Nobody would define it.” Wolf called his broker and asked about contango. “I don’t know what it is,” he replied. He called his other broker, at Charles Schwab. “He didn’t know either,” Wolf says. “He said he’d ask around.” Weeks later, after Wolf educated himself, he fired his Merrill broker and pulled his money out. (Merrill and Schwab declined to comment.) By then he had lost $2,500 on USO. “If it wasn’t a rigged game,” he says, “I could figure it out. But it is a rigged game.”

The Contango Trap

Contango is a word traders use to describe a specific market condition, when contracts for future delivery of a commodity are more expensive than near-term contracts for the same stuff. It is common in commodity markets, though as Wolf and other investors learned, it can spell doom for commodity ETFs. When the futures contracts that commodity funds own are about to expire, fund managers have to sell them and buy new ones; otherwise they would have to take delivery of billions



of dollars’ worth of raw materials. When they buy the more expensive contracts—more expensive thanks to contango—they lose money for their investors (see chart, page 53). Contango eats a fund’s seed corn, chewing away its value.

Here’s an example. The Standard & Poor’s Goldman Sachs Commodity Index (S&P GSCI), which tracks 24 raw materials, is the basis for as much as $80 billion of investment. Managers of funds linked to the index, created by Goldman in 1991, have to buy their next-month futures contracts between the fifth and the ninth business day of each month. During that period in May 2010, fund managers sold contracts for June delivery of crude oil



The performance of the U. S. Oil Fund (USO) has shocked and angered investors

priced at $75.67 a barrel, on average, according to data compiled by Bloomberg. Managers replacing those futures with July contracts had to pay $79.68. After the roll period ended, the July contract fell back to $75.43. For each of the thousands of contracts, in other words, managers paid $4 for nothing—and the value of their funds dropped accordingly.

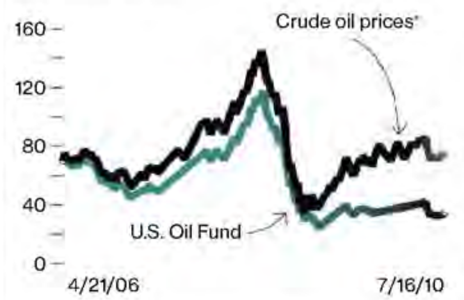
Contango isn't the only reason commodity ETFs make lousy buy-and-hold investments. Professional futures traders exploit the ETFs' monthly rolls to make easy profits at the little guy's expense. Unlike ETF managers, the professionals don't trade at set times. They can buy the next month ahead of the big programmed rolls to drive up the price, or sell before the ETF, pushing down the price investors get paid for expiring futures. The strategy is called "pre-rolling."

"I make a living off the dumb money," says Emil van Essen, founder of an eponymous commodity trading company in Chicago. Van Essen developed software that predicts and profits from pre-rolling. "These index funds get eaten alive by people like me," he says.

A look at 10 well-known funds based on commodity futures found that, since inception, all 10 have trailed the performance of their underlying raw materials, according to Bloomberg data. The biggest oil ETF, the U.S. Oil Fund, which Wolf bought and which now has $1.9 billion invested in it, has dropped 50 percent since it started in April 2006—even as crude oil climbed 11 percent. The $2.7 billion U.S. Natural Gas Fund, offered by the same company, has plummeted 85 percent since its launch in April 2007—more than double the 40 percent decline in natural gas. Deutsche Bank's PowerShares DB Agriculture Fund has eked out a 3 percent total return since January 2007, while the weighted average of its commodity components has risen 19 percent. To be sure, those spot prices—reported on cable business channels and other outlets—set an unreachable benchmark. If investors try to match the spot market using ETFs, they can get killed by contango. If they dodge contango by buying physical commodities instead, they must pay heavy storage costs that can easily turn gains to losses.

Oil

*Does not factor in the cost of storing commodities, which would lower actual returns



The allure of commodity investment has hit even the most sophisticated investors. The California Public Employees' Retirement System, the largest public pension in the U.S., has lost almost 15 percent of an $842 million investment in commodity futures since 2007, according to its latest filings, depriving it of income at a time when it has sought taxpayer money to cover retiree benefits. It defends the investment as insurance that will pay off in the event of inflation.

Just as they did with subprime mortgage-backed securities, Wall Street banks are transferring wealth from their clients to their trading desks. "You walk into a casino, you expect to lose money," says Greg Forero, former director of commodities trading at UBS. "It's the same with these products. You're playing a game with a very high rake, a very high house advantage, and you're not the house."

Consumers Take a Hit

Selling commodity investments has long required training in the futures markets. Selling commodity ETFs doesn't, says Michael Frankfurter, managing director of Cervino Capital Management, a commodity trading adviser in Los Angeles. Turning commodity futures into securities unleashed a much larger sales force—stockbrokers selling a product many of them didn't understand, he says. Passive buy-and-hold investors at one point in mid-2008 held the equivalent of three years of production of soft red winter wheat. Wall Street's success in attracting those buyers boosted demand for futures contracts, which helped determine what consumers would pay for baked goods.

Wheat prices jumped 52 percent in early 2008, setting records before plunging again, and sugar more than doubled last year even as the economy slowed, forcing Reinwald's Bakery in Huntington, N.Y., to fire five of its 32 employees. "You try and budget to make money, but that's becoming impossible to predict," says owner Richard Reinwald, chairman of the Retail Bakers of America. Cocoa futures reached a 30-year high early this year because of speculators,



Typography by Craig Ward

according to Juergen Steinemann, chief executive officer of the world's largest maker of bulk chocolate, Zurich-based Barry Callebaut. At the airport, the new $25 charge for checking a suitcase exists partly because airlines have to set aside cash to hedge against sharper ups and downs in oil prices, says Bob Fornaro, CEO of AirTran Holdings. "This has been very, very good for Wall Street," he says.

Sponsors of commodity ETFs and similar investments—including Deutsche Bank, Barclays, and UBS—warn of the risks in their prospectuses. Those banks declined to comment, but defenders say it's unfair to single out returns over any specific time period. "Diversification doesn't mean you're always going to be up, but you spread the risk differently," says Kevin Rich, a former Deutsche Bank executive who developed the first futures-based commodity ETFs in the U.S.

Not every trader is comfortable with what Wall Street has done. Forero, 36, became director of commodities trading at UBS in 2007. A New Yorker whose father was Colombian consul to the U.S., he began his career at JPMorgan Securities, then worked a series of energy-trading jobs before landing at UBS's securities division in Stamford, Conn., where the Swiss bank operates one of the world's largest trading floors. UBS had bought Enron's energy desk, so Forero sat among veterans of the disgraced company.

UBS sold notes linked to futures and earned commissions handling the monthly roll for clients such as USO, Forero says, adding that he didn't do the roll himself. ("That was a different group," he says.) In January 2009, stung by subprime losses that forced a Swiss government bailout, UBS shut its energy desk. Forero and his wife had a newborn daughter and a $1.2 million Colonial in Norwalk, Conn. With no job, Forero holed up in his home office, sifting through data with a Hewlett-Packard scientific calculator. He became convinced that the products he had sold were hurting investors and disrupting supply and demand for basic commodities.

"I've always been a little naïve, and maybe I still am," he says. "But how can the government allow that? People in our industry talk about it—everybody knows about it. This has to come to light."

"You walk into a casino, you expect to lose money," says Greg Forero, former director of commodities trading at UBS. "It's the same with these products.... How can the government allow that? People in our industry talk about it. This has to come to light."

The Birth of an Idea

Bob Greer spent long days during the mid-1970s in the basement of a public library in Tulsa, going through rolls of microfilm. He painstakingly copied commodity prices onto yellow legal pads, then tallied them up on a handheld calculator—piecing together the first investable commodities index. An economist and mathematician with a Stanford University MBA, Greer had worked at a commodities brokerage in Dallas, where he got the idea that raw materials might belong in investment portfolios, alongside stocks and bonds.

Greer's work in the library basement led to the publication, in 1978, of his first article on buy-and-hold commodity investing in the *Journal of Portfolio Management*. "Conservative Commodities: A Key Inflation Hedge" outlined the benefits of passive, unleveraged, long-only bets on raw materials. The idea didn't catch on, and Greer went into commercial real estate. At the time, everyone knew someone who had gone broke betting on soybeans, or a gold bug who hoarded coins against catastrophe, he says. Commodity investing wasn't respectable. "People did not believe that the words 'commodity' and 'investment' belonged in the same sentence," says Greer, now 63 and an executive vice-president at Pimco in Newport Beach, Calif.

Greer had long since given up on his idea by 1991, when Goldman launched its benchmark commodity index and began selling swaps that tracked it to institutional investors. Two years later, Daiwa Securities hired him to create an index based on the one he had dreamed up in Tulsa. Commodities investing was catching on, and Greer says a breakthrough came when the tech bubble burst in 2000. By 2002, when the Standard & Poor's 500-stock index plunged 25 percent, investors were desperate for alternatives. That year, Pimco hired Greer to start its Commodity RealReturn Strategy Fund. The actively managed fund has returned more than 200 percent since its debut.

While Greer was launching his fund, a natural resources consultant in Australia, Graham Tuckwell, was developing the first commodity ETFs. Tuckwell had worked for Salomon Brothers, Credit Suisse First Boston, and Normandy Mining, Australia's largest gold producer; by 2002 he was working with the Australian Gold Council, looking for a way to encourage gold investing. An acquaintance mentioned an oddball product: wine securities. They were "funny little things," Tuckwell says, that allowed cases of a particular vintage to be traded on a stock exchange. He decided his fund would work the same way. Instead of cases of wine, the shares would be backed by gold bars stored in a vault.

Tuckwell's innovation, rolled out in 2003 and then called Gold Bullion Securities, soon became a hit, and in April 2004 a contact at Royal Dutch Shell approached him with a question: Could he do for oil what he had done for gold? "An oil refinery takes an enormous amount of working capital because you have all this crude oil sitting there," Tuckwell says. He went to Shell and pitched a product that would help the company make money from the crude it keeps in storage.

Backing the oil ETF shares with the physical commodity proved unwieldy. Gold was compact and easily stored in a vault; oil was in depots, pipelines, and tankers all over the world. Instead, Tuckwell's London firm, ETF Securities, entered into a swap agreement with Shell. Tuckwell used investors' money to buy contracts from Shell, and Shell gave them the same return as crude oil, based on the price of Brent crude futures. Since the oil ETF started trading in London in 2005, Brent has risen 30 percent; the fund has dropped 27 percent. The risks are clearly outlined in the prospectus, Tuckwell says, and anyone who doesn't understand the product first shouldn't buy it.

Banks used new academic research to pitch commodities as a safe way to diversify. In one 2004 presentation, Heather Shemilt, then a managing director and now a partner at Goldman, called the strategy "the portfolio enhancer." That same year two professors, Gary B. Gorton of the Wharton School and K. Geert Rouwenhorst of Yale University, published a paper,

funded in part by AIG, which argued that an investment in a broad commodity index would have brought about the same return as stocks from 1959 to 2004, and would often rise when stocks fall. Under the crystal chandeliers of San Francisco's Palace Hotel in June 2005, Rouwenhorst presented his findings to more than 100 investment pros; Shemilt also appeared, alongside managers from Barclays and AIG. After the talk, many in the audience had the same question: How do I do this?

Barclays, Goldman, AIG, and other firms had developed ways to help them do it–several types of investments based on futures contracts, which had been used for almost 150 years to arrange the price and delivery of a given commodity at a specified place and date. These products remained the province of wealthy investors. In 2004, however, Deutsche Bank's Rich devised a commodity ETF that opened the door to retail investors when it launched two years later. There was an obstacle: The U.S. Commodity Futures Trading Commission, a regulatory board created in 1974 after a runup in grain prices, required buyers of certain commodity investments to sign a statement saying they understood the risks. The banks argued that it would be impossible to collect so many thousands of signatures for a product designed to trade like a stock. In 2005, Deutsche Bank lawyer Greg Collett, who had worked at the CFTC from 1998 to 1999, helped persuade the commission to waive the rule and let funds replace it with their prospectus. That would provide adequate warning, the CFTC concluded. Collett says he believed the fund "democratized" commodity investing.

Rich started attending National Grain & Feed Assn. conferences to introduce ETF investors to the traditional players, such as farmers and silo operators. One conference featured a boat ride up the Illinois River to visit a grain depot, giving Rich a chance to explain his new ETFs to old-school grain traders. "They were a bit suspicious," he says.

These days, the Wall Street banks are more like those grain traders than you might think. They have equipped themselves to take delivery of raw materials when they choose to, so they can wait for the commodity price to rise without having to roll contracts, giving them another advantage over ETF investors. Goldman owns a global network of aluminum warehouses. Morgan Stanley chartered more tankers than Chevron last year, according to shipbroker Poten & Partners. And JPMorgan Chase hired a supertanker to store heating oil off Malta last year, likely earning returns of better than 50 percent in six months, says oil economist Philip Verleger. "Many, many firms did this," he adds, explaining that ETF investors created this "profitable, risk-free arbitrage opportunity" when they plowed into commodities. Futures are bilateral; if someone's buying, someone else is selling. "And the only way to attract sellers is to offer them a bigger profit," Verleger says. "So, ironically, passive investors have been sowing the seeds of their own defeat"–and contributing to the contango that does in their funds.

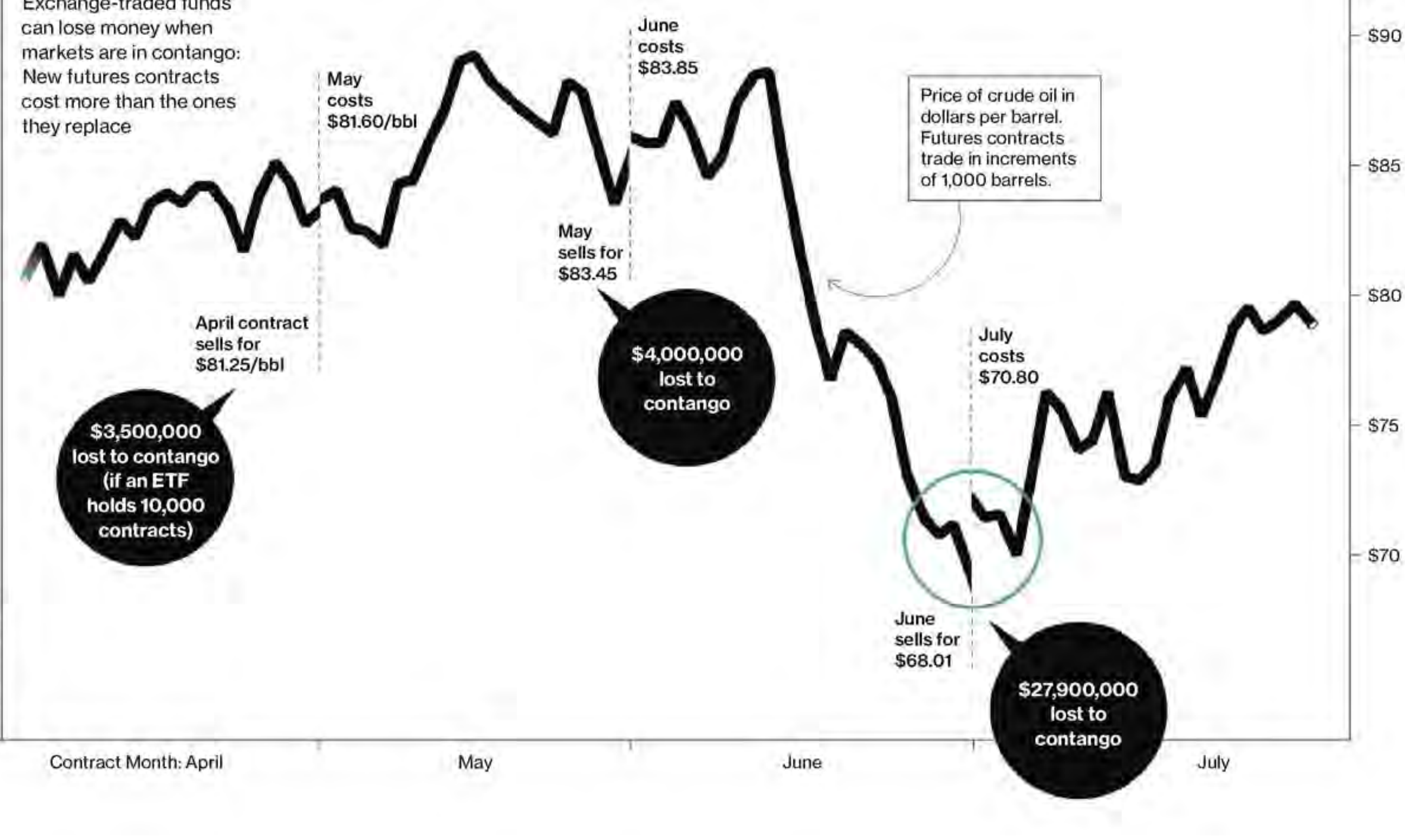
Even the former Deutsche Bank lawyer who helped open the floodgates now says something has gone wrong. "Like most things on Wall Street, they have been over-marketed," Collett says. "The complications have been glossed over. I'm not sure the people marketing them even understand the complications, and that's a shame." Collett left Deutsche in 2008 and is pursuing a career as a stand-up comic in New York.

Poster Children

If you're going to serve as de facto spokesman for the commodity ETF industry, it probably helps to have played college rugby. John Hyland is the chief

Death By a Thousand Cuts

Exchange-traded funds can lose money when markets are in contango: New futures contracts cost more than the ones they replace



DATA: BLOOMBERG



The U.S. Natural Gas Fund (UNG) fell along with natural gas but didn't rally with it

investment officer of U.S. Commodities Funds, the Alameda (Calif.) company that manages USO and its sister fund, U.S. Natural Gas. Majoring in political science at the University of California at Berkeley in the late 1970s, Hyland played the rugby position called hooker, which requires toughness and fancy footwork to jerk the ball out of the scrum. "My wife calls me the human battering ram," he says. For the past year he's been trying to keep his funds out of a regulatory pileup.

Hyland, 51, had never managed commodities before he joined U.S. Commodities in 2005. He had been in the investment business for 20 years—running portfolios and mutual funds—before he teamed up with U.S. Commodities CEO Nicholas Gerber. In 2006, as Gerber and Hyland were trying to win approval from the Securities & Exchange Commission for the U.S. Oil Fund, the fund's prospectus hit the desk of Dan McCabe, then CEO of Bear Hunter Structured Products, which was to be the fund's first market maker. McCabe recalls immediately spotting how traders would pick USO apart.

"Anybody who looked at it prior knew exactly what would happen," McCabe says. "From a trading side—and I spent most of my life trading—I would say, 'Wow, what a great opportunity.'"

After Hyland's oil and natural gas funds surged in 2008 and 2009, he found himself in the crosshairs of the Commodities Futures Trading Commission, which was holding hearings on energy speculation in the wake of $147-a-barrel oil. CFTC Chairman Gary Gensler began calling for limits on the number of energy contracts a single trader can hold. As Hyland's ETFs became poster children for the problem, Hyland became their most vocal advocate. At an ETF conference in Boca Raton, Fla., in January, he showed up with bottles of Merlot stamped with the company logo and the words "California Crude." The chances of pre-rolling his funds, he maintains, are "historically a 50-50 crapshoot"—a view many traders reject. His funds track daily moves in futures prices, he continues, because spot prices are impossible to capture unless you store fuel yourself. "I don't think the products are flawed," he says. "They do what they say they're supposed to do."

Natural Gas

*Does not factor in the cost of storing commodities, which would lower actual returns.



On Feb. 6, 2009—to cite one example—USO did what McCabe guessed it might. It gave traders an opportunity to profit at the expense of the fund's investors, McCabe says. With oil prices near their lowest in more than four years, long-term investors like Wolf had flocked to the fund; its monthly roll, taking place that day, had grown so large that it represented financial contracts for nearly 78 million barrels of oil, roughly four times the amount of oil the U.S. consumes in a single day. On Feb. 6, the price spread between expiring crude oil futures and those for the following month widened by $1.39 a barrel, or 30 percent, to $5.98. The price jump was so extreme that the CFTC announced an investigation within weeks, saying it "takes seriously issues surrounding price movements in our nation's vital energy markets."

In the midst of the price swing, according to an account released by the CFTC in April, a Morgan Stanley trader made a secret deal with a broker at UBS, acting on behalf of USO. Around noon, Morgan Stanley agreed to buy 33,110 of the fund's expiring March contracts and sell it April contracts, the CFTC said. The Morgan Stanley trader asked UBS to keep the trade quiet—a violation of New York Mercantile Exchange (Nymex) rules—until after the 2:30 p.m. close of trading that day.

The secret deal was breathtakingly large, equivalent to 12 percent of March futures on the Nymex. At the end of the day, USO and its investors lost because of the extreme contango: They could afford fewer of the more expensive April futures than they had in March, Forero says after analyzing Bloomberg data. Buying the same amount of oil would have cost $466 million more, he estimates. "You can either get screwed out of money or you can get screwed out of product," he says. "They had to pay more for effectively the same barrels."

The CFTC told the oil fund it may be held "vicariously liable" for UBS's ac-



tions, according to a March filing with the SEC. Hyland says he knew nothing about the deal. In April the CFTC ordered a $14 million civil fine for Morgan Stanley and $200,000 for UBS for failing to report the trade as required. The CFTC declined to explain how it arrived at the amounts or to disclose Morgan Stanley's profit. UBS declined comment. "Morgan Stanley fully cooperated with the CFTC and is pleased to have reached a resolution with our regulator," says company spokeswoman Jennifer Sala. "This matter concerned an isolated request by a former Morgan Stanley trader."

Without knowing Morgan Stanley's trades, Hyland says, it's hard to determine whether the bank's actions harmed investors. "The best that you can do as the provider of investment products is lay out, in as much detail as you think people can absorb, the hows, the whys, and the risks," he says. Page five of the fund's 86-page prospectus includes this disclaimer: "The price relationship between the near month contract to expire and the next month contract to expire ... will vary and may impact both the total return over time ... as well as the degree to which its total return tracks other crude oil price indices' total returns."

Hyland's other main fund, U.S. Natural Gas (UNG), got so big last year that at its peak it owned the equivalent of 86 percent of the near-month natural gas contracts on the Nymex. As natural gas prices fell into the basement–traders call the notoriously volatile market "The Widowmaker"–UNG fell with them, and when gas prices rallied, UNG did not. The fund's growth raised concerns among regulators at the CFTC, which last year began debating position limits; it will revisit the issue this year. The fund grew so large it had to freeze its position and start buying over-the-counter derivatives–unregulated contracts tied to gas prices–instead of futures. Hyland told the CFTC last year that it was "gibberish" to say UNG had any effect on natural gas prices.

New Oversight?

The financial reform bill President Barack Obama signed on July 21 includes a few provisions that may help the CFTC address the commodity ETF mess. The new regulations enhance the CFTC's ability to prosecute trading abuses, and set position limits on over-the-counter swaps, like those UNG has been buying. How much the new law will help remains to be seen, says Jill E. Sommers, one of the agency's five commissioners, because Congress still needs to appropriate funds and write guidelines for implementation and enforcement. "We'll need additional dollars to carry this out," she says, adding that it's too early to say whether the CFTC has the authority needed to crack down on pre-rolling. "We're at the beginning of the rule-writing process, so it's premature to say whether additional authority is going to be needed," she says.

Wall Street banks take delivery of raw materials, then wait for the commodity price to rise. Goldman owns a global network of aluminum warehouses. Morgan Stanley chartered more tankers than Chevron last year, according to Poten & Partners.

By requiring the commission to impose caps on energy trading within a year, the rules may limit the size of some funds. It does nothing to directly address the market impact of the funds, says CFTC commissioner Bart Chilton. He likens ETF investors' supersized role to the one Tom Hanks played in the 1988 film *Big*–a little boy in a man's body. "The dynamics of the market have changed so dramatically over the last several years with this new influx of capital that is massive in size and passive in strategy," Chilton says. "That has had an impact that wasn't anticipated."

The CFTC's explicit responsibility is to guard against commodity market distortions, not to look out for ETF investors like Gordon Wolf. "We are concerned about both," says Sommers. Adds Gensler: "The CFTC is aggressively using its authority to police the markets for fraud, manipulation, and other abuses. Investors also should fully research any products before they buy." As Hyland likes to point out, the risks are described in each fund's prospectus. Now investors are learning what those words actually mean. B

Typography by Marta Cerda

Who's Afraid Of Steve Jobs?

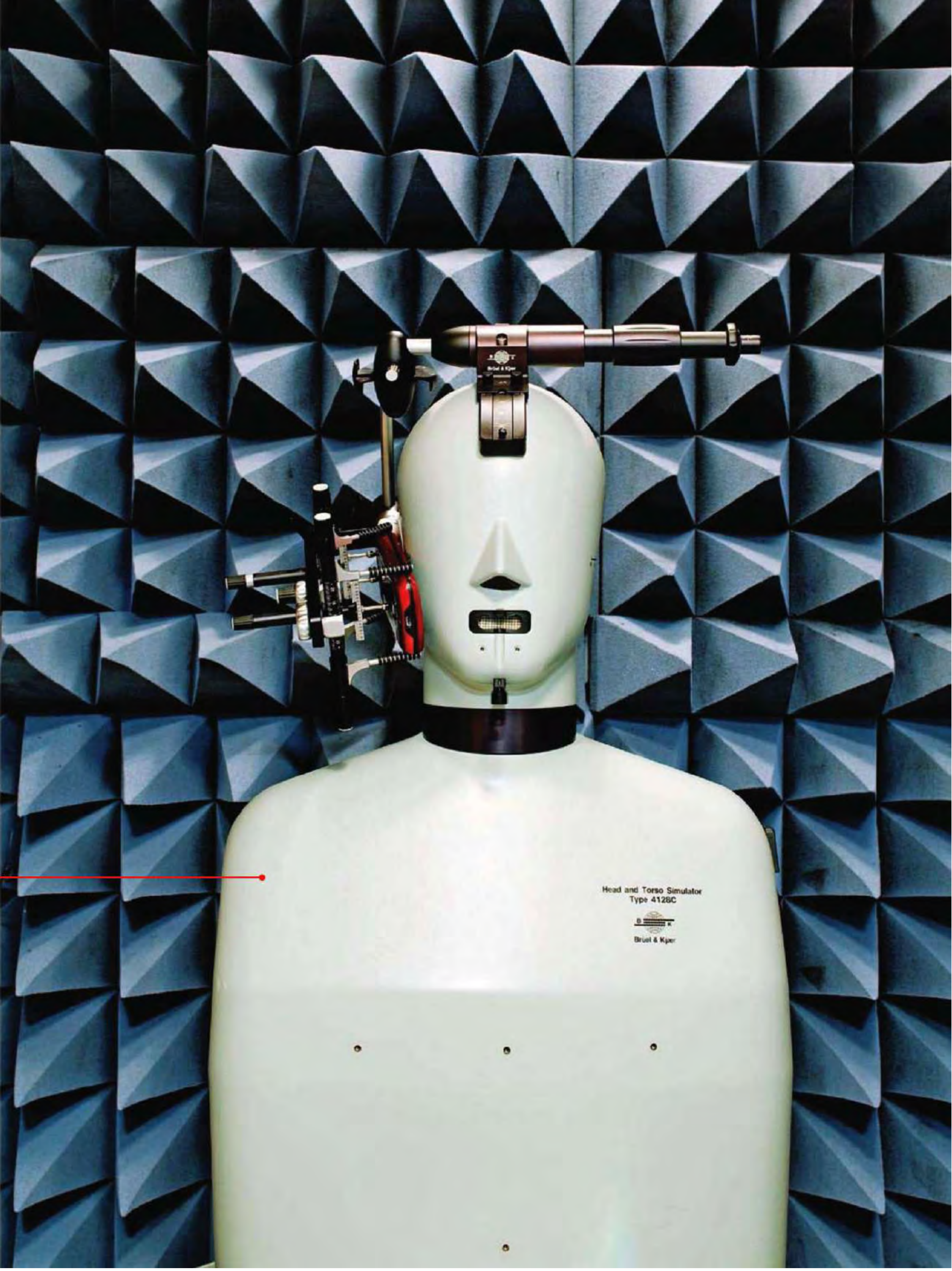
Test subject: Cell Phone

Method: Strap onto a dummy's head and measure reception in an isolation chamber

Not *Consumer Reports.* Over the past year the 74-year-old magazine has carved up Apple and made Toyota roll over. Pretty good for a lab in Yonkers.

By Devin Leonard

Photographs by Floto+Warner


Head and Torso Simulator
Type 4128C
Brüel & Kjær

Test subject: Baby Crib | **Method:** Pummel infant beds with a device simulating a heavy child jumping up and down

Two decades ago, when *Consumer Reports* started evaluating treadmills, it built a test machine it called the Johnny Walker. A drum-like steel cylinder studded with green rubber balls, the Johnny Walker spins above the rolling belts of its victims, pummeling them with blows meant to simulate the footsteps of a 170-lb. runner. In the early days, after a few hours of insistent pounding, some treadmills caught fire.

The fitness equipment industry has since figured out that it can't incinerate its customers–and the Johnny Walker keeps racking up the miles. It recently beat one treadmill so badly that the machine's motor fell out. The manufacturer suffered the consequences in the pages of the magazine, earning a rare yellow box with a check mark, which is even more dreaded than the more frequently seen black "blob" for poor performance in *Consumer Reports'* unique graphical rating system. (Total approval, as longtime readers know, is a red blob completely filled in.) "We gave that one a 'don't buy' rating," says Rich Handel, one of the magazine's 107 professional testers.

The Consumer Reports National Testing & Research Center is housed in what was once the headquarters of a mimeograph company in Yonkers, N.Y. It is designed for the scientific torture and performance rating of almost anything that can be purchased. In the same room as the Johnny Walker is a machine that drops bike helmets on anvils to see how well they will protect the heads of cyclists.

Down the hall, tester Nelda Adell oversees a Rube Goldberg-like contraption with a long, machine-driven arm that robotically scrubs pots with steel wool. It's set to administer 500 scrubs, but Adell says no pot has made it past 400 without a mark. "Some of them say they have a 20-year guarantee," she says.

There's something charmingly retro about *Consumer Reports,* which is published by Consumers Union, a nonprofit advocacy group with 640 employees. It's a no-frills, not-for-profit publication that prizes the credibility of its ratings above all else. The magazine has never taken an advertisement. "The only people they have to answer to are their customers, the readers," says Samir Husni, a magazine consultant in Oxford, Miss. "They don't have to think twice about saying anything–good or bad–about a product." You'll never hear of *Consumer Reports* cutting a deal with Angelina Jolie for a cover shot. When the magazine needs models for a photo spread, it often grabs its own employees and snaps photos of them under the hoods of cars or painting decks.

In the past six months the 74-year-old magazine has challenged some of the world's most trusted consumer brands. In April, Toyota Motor recalled its 2010 Lexus GX 460 SUV after the magazine put the car through tests at its automobile testing operation in East Haddam, Conn., and branded it a "Don't Buy: Safety Risk." Testers discovered that if they drove the vehicles quickly around turns, the rear end spun so much that it was nearly sideways before the electronic stability system kicked in. As far as *Consumer Reports* was concerned, that made the GX 460 a rollover threat. (Toyota has since upgraded the SUV's software, and the magazine lifted its "Don't Buy" recommendation after a retest.) "*Consumer Reports* brought it to our attention, and we fixed it," says Lexus spokesman Bill Kwong.

In early July, *Consumer Reports* did something even more remarkable: It paused the Apple juggernaut. Shortly after the June 24 release of its iPhone 4, Apple received complaints that the phone dropped calls when users touched the device's lower left corner. Apple shrugged off the problem. It said most mobile phones lose reception when they're gripped "in certain ways." The iPhone's problems, it insisted, were exacerbated by a software glitch that made reception look worse than it actually was.

That might have been the end of "Antenna-gate" except that on July 12, *Consumer Reports* weighed in. The magazine lavished praise on the phone, saying it "has a sharper display and the best video camera we've ever seen in a phone." It also said that it had tested the device's new external antenna and found it lacking. "Due to this problem," it stated, "we can't recommend the iPhone."

A flood of calls

"Is something happening today?" asks Jim Guest, chief executive of Consumers Union. "I've heard a rumor ..."

On the day Apple held an elaborate press conference to respond to *Consumer Reports,* the magazine's offices are humming only a bit more than usual. Ken Weine, the organization's vice-president for communications, is on edge–and with good reason. He would be flooded with calls after Jobs was finished speaking. Guest, a 69-year-old with the smooth charm of a college president, is serene. *Consumer Reports'* coverage of Apple, he says, is just another example of how his organization remains true to its mission of making sure companies deliver what they promise. "From our perspective," says Guest, "we test, and we report good, bad, or indifferent. We are all about products. If this product had been made by someone else, we would have done the same thing."

In his press conference, Jobs emphasized that his company did its own extensive testing on the iPhone 4. He pointed out that Apple has invested $100 million to construct a state-of-the-art lab devot-

Paul Reynolds, electronics editor, oversaw the magazine's iPhone coverage




100LB
TROEMNER



Test subject: **Sneakers** | Method: Strap on fake feet attached to mechanical legs and flex them repeatedly

ed to antenna design and testing, with 17 performance measurement chambers. (That's more than three times larger than *Consumer Reports*' total product testing budget in 2009.) Still, Jobs didn't take on the magazine. He offered disappointed users a free "bumper case" that would cover the trouble spot. "We were stunned and upset and embarrassed by the *Consumer Reports* stuff that came out this week," the Apple CEO said.

"You had two essentially immovable objects—the credibility of *Consumer Reports* and the credibility of Apple—running directly at each other," says Matt Traub, a managing director at DKC, a New York crisis management specialist. "The question was whose credibility would run the other's off the road. We got the answer last week."

Consumer Reports is still withholding its coveted blessing. The magazine called Apple's fix "a good first step," but it has yet to recommend the new iPhone.

It's hard not to wonder what the founders of *Consumer Reports* would have made of Antenna-gate. Consumers Union was founded in 1936, right in the middle of the Depression, by idealists and scientists determined to dispel the hype used by corporate America to sell things. To do so, they started a magazine called *Consumers Union Reports*. They launched with so little money that, by necessity, the first tests were on cheap stuff, like breakfast cereal and Alka-Seltzer.

The founders' mission was considered heretical at the time. *Reader's Digest* branded them dangerous subversives for challenging the veracity of big business, writing, "They are out to discredit, if not destroy, the system." *Good Housekeeping* went so far as to accuse *Consumer Reports* of extending the Depression. Relations between the titles were not helped by the fact that *Consumer Reports* dismissed *Good Housekeeping*'s Seal of Approval as a "fraud."

Still, the magazine's subscriber base grew, and its content began to influence American consumer culture. In the early '50s the magazine created a smoking machine that collected the residue of a user's inhalations in a flask. In 1953, it reported that smokers were exposed to as much nicotine when they puffed a filter-tipped cigarette as they were when they lit up an unfiltered Lucky Strike. The U.S. Surgeon General's advisory committee cited the magazine's research in its landmark report warning of the dangers of smoking in 1964. *Consumer Reports*' toy testing helped pave the way for the 1969 Child Protection & Toy Safety Act, which passed a year after the magazine tested a group of electric toys and found a quarter of them hazardous.

By the late '90s, however, consumer appetites had moved beyond the utilitarian to Lexuses and stainless steel six-burner "professional grade" Viking stoves. *Consumer Reports* didn't test such aspirational purchases, and the magazine slipped into the red. In 2001 the organization lost $9.4 million. "I think we had gotten a little complacent," says Guest. "For a long time, we were the only game in town. Now there was all sorts of stuff out there on the Web."

Guest, who has previously served as the nonprofit's chairman, became president that same year and made two important decisions. The first was to get the magazine to lighten up a little. As the real estate market took off, the magazine started covering such heretofore untouchable products as luxury SUVs, wine, and high-end mobile devices like the iPhone. Since the onset of the recession, *Consumer Reports* has also had fun putting less expensive infomercial-level fare in its pages, such as the Amish heater

Test subject: **Pizza** | Method: In blind conditions in the sensory lab, experts taste slices





Test subject: Washers

Method: Stuff them with fabric prestained with blood, wine, and coffee

and the Snuggie. Testers were pleasantly surprised by the heater, saying it did a "good job," but not to "expect any miracles." They were less charmed by the Snuggie, which is sold in pairs for $19.99, noting, "When washed, it shed. Each time we laundered two Snuggies, we removed a sandwich bag's worth of lint from the dryer screen."

Guest's second decision was to expand testing to keep up with the torrent of new products hitting the market. Where it once might have weighed in on the television or computer market in an annual special issue, it now continually tests laptops, cell phones, and flat-screen televisions, posting results on the Web as quickly as possible to help subscribers make buying decisions. *Consumer Reports'* online subscriptions have tripled in the past seven years, and the magazine's future growth clearly lies on the Internet. It's also where the magazine rushes to post announcements, such as its decision not to recommend the iPhone 4.

Consumer Reports even went after younger readers in 2009 when it bought Consumerist.com from Nick Denton's Gawker Media. Consumerist.com runs such posts as "An iTunes Thief Ran Up $200 on My Card, Customer Service Won't Help" and "I Persevered Through Comcast's Incompetence, Got a Nice Prize." It's a far cry from the lab-jacket-clad, irony-free voice of the mother ship, but *Consumer Reports* thinks its important to have such a presence in the blog universe. "They have a strong voice and a passionate audience," says John Sateja, executive vice-president of Consumers Union.

The magazine has been profitable since 2003, though there have been cultural clashes over its aggressive push into the online world. The magazine's research group, which prides itself on the accuracy of its consumer surveys, protested when the magazine started posting readers' opinions along with its scientific ratings on the website. "The researchers said, 'We are scientists. Why are we doing that? It's just people's opinions,'" says Jerry Steinbrink, vice-president for publishing at Consumers Union.

Handwringing ensued when the magazine struck a deal with PriceGrabber.com to add links to sites where users could buy products that *Consumer Reports* had rated. Some on the board feared the magazine was promoting shopping rather than smart decision-making and thrift. The shopping links are still there, and so are the user opinions. And neither of these additions has shaken the public's faith in the brand.

Credibility is *Consumer Reports'* business—and business is booming. The magazine has 7 million subscribers—nearly half of whom pay $26 a year for access to its website, ConsumerReports.org. That's almost three times as many paid digital subscribers as *The Wall Street Journal*, one of the few other publications to get people to pay for its online content.

Consumer Reports continues looking for new ways to help readers, no matter how annoying to big companies. Right now, they're working on an iPhone application that will let users scan bar codes and get the magazine's product ratings while they're shopping. The magazine will need Apple's permission to offer it in the company's app store. Consumer Reports doesn't anticipate any problems with approval. ❸



DeMoro, at a nurses' union rally, rarely has trouble being heard

Rose Ann DeMoro Wants Hospitals To Scream



By Dune Lawrence

Photograph by Robyn Twomey

This past April, Rose Ann DeMoro—a former supermarket cashier from St. Louis—looked at billionaire California gubernatorial candidate Meg Whitman and had an idea. DeMoro found a Los Angeles drama teacher, dressed her in a crown and faux ermine, and sent her out to tail Whitman across the state. Joined by tuxedoed bodyguards named "Goldman" and "Sachs," "Queen Meg" now spends her days taunting Whitman up close. "The new corporate aristocracy, they're used to unilateral control, no democracy," says DeMoro. "The script just wrote itself."



Whitman taunter Queen Meg, with escorts Goldman and Sachs

DeMoro is expert at dishing out political pain with a flourish, a talent that has endeared her to her 86,000 constituents in the California Nurses Assn. Under DeMoro's leadership, the union has recast itself from a special-interest trade group to a consumer and patient advocate that lobbies hard—and volubly—for universal health care and patients' rights. As membership in organized labor has withered nationwide, reaching a record low of 7.2 percent in the private sector last year, CNA's rolls have increased fivefold since DeMoro took over in 1993. It now represents about a quarter of the state's working nurses. "Nurses are the last line of defense for patients," says DeMoro from a seat in her cactus-filled office at the union's Oakland headquarters. "This isn't about just bread-and-butter issues for registered nurses, this is about living in a good and a just society."

Having spent the past six years creatively torturing California Governor Arnold Schwarzenegger, DeMoro, 61, would like to take her cause national. In December, CNA linked with United American Nurses and the Massachusetts Nurses Assn. to form the 155,000-member National Nurses United (NNU). DeMoro was named executive director, and she aims to turn NNU into a superunion of the nation's 2.6 million registered nurses. That will take some doing. Many RNs already belong to other unions. But if NNU recruits across the country at the same rate that it has in California, it would have 650,000 members and the ability to strike hospitals on a national scale.

DeMoro already looms large enough to her California opponents. The Whitman camp retaliated for the "Queen Meg" routine with a website noting that "Boss Rose," who isn't a nurse, has a salary of more than $293,000, almost five times the median for nurses nationally. The site also accuses her of turning the union into "an arm of the California Democratic Party" aligned with Whitman's opponent, Jerry Brown, whom the union endorsed in March. To which DeMoro replies gleefully: guilty as charged. "Everybody's supposed to believe that in order to be a reasonable person you have to believe that we're all in this together," she says. "I'm an advocate, I'm on a side."

DeMoro grew up working-class. Her Italian father ran a pizza parlor, her Irish mother operated a beauty salon. One of six siblings, she and a brother were the first in her family to go to college. DeMoro met her husband in high school, and after college at Southern Illinois University they moved to California in 1977, where DeMoro pursued a doctorate in sociology at the University of California at Santa Barbara. She was writing her dissertation on supermarket cashiers (titled "Checking Out Sexism") when she decided she'd rather organize than teach.

Her mission remains unabashedly grounded in women's empowerment. More than 90 percent of CNA members are women, and a wall in DeMoro's office bears a sign saying "Well Behaved Women Rarely Make History." "Nurses have been held down," DeMoro says, and part of her job has been to create a "culture of feminism" that helps them fight back.

DeMoro is pushing to expand the union's power at the precise moment her top priorities—increased salaries and benefits and more legally mandated jobs for nurses in hospitals—face unprecedented obstacles. The health-care reform bill passed in March is expected to cut federal spending and increase revenue by $1.1 trillion over the next 10 years, with approximately $300 billion extracted by lowering Medicare and Medicaid payments to hospitals. "In health care, everyone's looking for offset effects, or what politicians call win-win," says Jonathan Gruber, an economist at the Massachusetts Institute of Technology. "Is paying nurses more win-win? There's certainly no evidence."

DeMoro argues that low pay and understaffing don't bend the cost curve, they break it. Patients get sicker because of mistakes and inadequate monitoring, which lengthens hospital stays and pushes costs higher. Under such stressful conditions, nurses are less likely to want to stay in the job, which adds to turnover costs. "Every day and every shift there are people who fall through the cracks," DeMoro says. Her favored solution, modeled on a California law passed in 1999 and implemented in 2004, is the establishment of a fixed minimum nurse-to-patient ratio in hospitals nationwide.

A study led by Linda H. Aiken of the University of Pennsylvania published in the April issue of the journal *Health Services Research* provides some ammunition for this view. Aiken found that matching California's nurse-patient ratios would have reduced surgical deaths in hospitals in New Jersey and Pennsylvania by 13.9 percent and 10.6 percent, respectively. (The California ratios vary from 1 nurse to 2 patients in intensive-care units to 1 to 5 in general medical surgical units.) The study also discovered higher nurse job satisfaction when hospitals met the staffing levels set by California. Illinois, New York, and New Jersey are all considering legislation similar to California's, and Senator Barbara Boxer (D-Calif.) introduced a bill over a year ago that would make ratios a federal requirement.

If the health-care bill is a challenge to DeMoro's goals for the NNU, the demographics of the industry present an unprecedented chance to expand the union. The ranks of registered nurses will swell 22 percent in the 10 years to 2018, according to estimates by the Bureau of Labor Statistics. Union membership grew to 13.6 percent of health-care practitioners in 2009, from 12.9 percent in 2000, as the group, which includes doctors and nurses, grew to 7.1 million, from 5.3 million. "The health-care sector is definitely high on the list of areas of op-

EDWARD CALDWELL

portunity for unions," says Ken Jacobs, chair of the Center for Labor Research and Education at the University of California at Berkeley. Rising demand "gives nurses leverage. I think we can expect them to be aggressive in organizing and bargaining and expect some success."

DeMoro has cast Whitman as a natural adversary to the cause—and the former eBay CEO is the only subject that brings about a noticeable change in DeMoro's usually cheerful demeanor. Whitman is running for governor on a platform of tax breaks for businesses, the elimination of 40,000 state government jobs, and budget cuts of $15 billion that will be difficult to achieve without huge reductions in social programs, including health-care spending. DeMoro contrasts Whitman's campaign for governor—"consultant-run" and "off the shelf," she says—with what she describes as her own bottom-up management style. Whitman spokesman Tucker Bounds points out that his candidate supports the ratio law in California, and on a website aimed specifically at nurses, Whitman promises to plow savings from welfare reform into nursing education.

That Whitman broke the corporate glass ceiling and says she supports the biggest plank in the CNA platform earns her no quarter from DeMoro. The union leader says she even prefers Schwarzenegger to Whitman—which means DeMoro either really dislikes Whitman or is suffering from a remarkable case of political amnesia. In 2004, Schwarzenegger tried to suspend California's ratio law before it could take effect, arguing that it would cost hospitals too much money. CNA unleashed its trademark theatricality, putting the governor up for "auction" on eBay, distributing Schwarzenegger masks for Halloween (stamped as "property of" major corporations), and packing his public appearances as far afield as Boston with gangs of outraged nurses. CNA kept the heat on with more than 100 protests in 12 months, helping force the governor to implement the ratio law. "When Arnold Schwarzenegger was elected, his shadow covered the state," says Harvey Rosenfield, the founder of the Los Angeles-based nonprofit Consumer Watchdog. "DeMoro took him on when everybody else was terrified of him." Schwarzenegger spokesman Aaron McClear declined to comment on DeMoro or the union.

Rosenfield also credits DeMoro for helping universal health insurance bills pass the state legislature twice, only to be vetoed by Schwarzenegger. "Health care should not be a commodity," she says. "There's money there. They afford it in every other industrialized country. They can afford it in California and the nation."

'Everybody's supposed to believe that in order to be a reasonable person you have to believe that we're all in this together. I'm an advocate, I'm on a side.'

When the California Nurses Assn. hired DeMoro away from the Teamsters in 1986, few nurses had retirement benefits or spoke to union representatives. CNA was mostly résumé padding for the nurses in hospital management positions who dominated the board, DeMoro says. She recalls an organizer receiving a letter of reprimand for using the word "strike."

DeMoro quickly aligned herself with bedside nurses who wanted more say in the organization and more focus on working conditions. California was a forerunner of the managed-care movement, which sought to cut costs and restructure hospitals, including cutting the number of nurses. DeMoro helped lead a campaign to replace the union's board with staff nurses and became executive director when staff nurses won control.

Under DeMoro, the union threw itself into the broader fight for patients' rights in the face of consolidation in hospital chains and insurers. The NNU simply takes that fight national, says DeMoro. In just eight months the group has already had an impact; in Texas, which has a unionization rate of only 5.1 percent, the NNU just concluded the state's first-ever union nurses' contract, winning a 10.5 percent raise over three years from Cypress Fairbanks Medical Center Hospital in Houston. DeMoro says the NNU aims to add nurses throughout the South and in Catholic hospital chains in the Midwest.

NNU has also supported two strikes in the last few months—a 1,500-member, month-long action to protect benefits at Temple University Hospital in Philadelphia and a 12,000-member, one-day strike against 14 hospitals in Minnesota. The strikers got much of what they wanted in Pennsylvania, including continued tuition remission for dependents at the university. Minnesota nurses stymied changes to pension contributions but settled for the employers' offer of a 3 percent salary increase over three years and achieved nothing on minimum staffing ratios.

A study co-authored by MIT's Gruber and published by the National Bureau of Economic Research in March found that hospital deaths rose 19 percent during walkouts, based on 20 years of data from New York State. "I don't think standing on a corner yelling and screaming shows a patient advocate," says Sherwood Cox, a critical-care nurse at California's Western Medical Center Santa Ana, who has helped defeat two CNA organizing drives and started a website called Stopunions.com.

DeMoro says she's "completely comfortable" using walkouts to make a negotiating point. (Private hospitals get 10 days legal notice of work action, warning time that allows them to reschedule elective procedures.) She expects more strikes because "employers are testing the nurses, they're trying to get ahead of the nurses' power."

Getting ahead of that power is DeMoro's job, and while she's had unprecedented success in uniting her constituents, it remains to be seen whether she can go beyond inspiration and taunts to achieve the change she's promised. Her attitude toward hospitals and insurers ("They think I'm radical, that basically it's unreasonable that I think that the nurses should win every battle, but I do.") doesn't suggest a demeanor amenable to shifting from agitator to stateswoman. Which means DeMoro's opponents should expect lots more pain in the years ahead. Ⓑ

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Getting Dirty in Dutch Country

Despite the publishing industry's woes, romance fiction is on the rise, fueled by the success of some unusual subgenres. *By Spencer Morgan*

Illustration by Jon Stich

Etc. Romance Novels

Legend has it that the first thing Gutenberg printed on his press was a beloved German poem. The second thing was an article on the death of publishing.

It's an old joke–and still relevant. The Association of American Publishers reports that U.S. book sales dropped by 1.8 percent in 2009, after a decline of nearly 3 percent the previous year. Books appear to be suffering a slow and rather boring death.

Except for one genre experiencing steady and unusual growth. In 2009 romance novel sales continued to defy industry trends, increasing to $1.4 billion, up $100 million, or 7.7 percent, from the previous year, according to Simba Information's annual Business of Consumer Book Publishing report. Romance now accounts for 14 percent of all works of fiction sold. Some 75 million people read at least one romance novel in 2009, and it's the top-performing category on the best-seller lists compiled by *The New York Times*, *USA Today*, and industry trade *Publishers Weekly*. At the end of July about 2,000 rabid fans and aspiring authors will shell out more than $400 to attend the Romance Writers of America's annual conference in Orlando.

When you consider that everyone's idea of romance is different–and constantly evolving–these impressive numbers take on mind-blowing dimensions. To satisfy as many lust-filled imaginations as possible, the romance fiction industry has ripped the bodice from seemingly every niche group. Nascar and transgender-themed romances are finding their way to shelves already packed with Amish, Mennonite, quilting, knitting, paranormal, and military subgenres. "We're going gangbusters!" says Katherine Orr, vice-president for public relations at Harlequin Enterprises, the genre's powerhouse publisher. Harlequin had revenues of $485 million last year, a figure Orr says is consistent with a strong upward trajectory over the last five years.

Some 75 million Americans read at least one romance novel in 2009

"People want to buy a book that incorporates exactly what they care about," says Nancy Berlin, an agent who represents several knitting romance writers. Readers also want reasonably priced pleasures, and publishers are delivering with inexpensive paperbacks. "In these tough times," says Berlin, "readers don't want to waste those seven dollars."

The most popular microtrends of the moment are Amish- and Mennonite-themed romances, which covered the best-seller lists last fall like a giant head scarf. What was considered a holiday season fad has persisted–and even narrowed. "I have noticed a new trend within the Mennonite genre toward Amana romances," says author Cindy Woodsmall, whose books have appeared on *The New York Times*' mass-market fiction best-seller list, referring to an ultraconservative strain of Amish. Woodsmall's *The Bridge of Peace*, about an Old Order Amish schoolteacher with a peculiar birthmark, is due out in August.

Earlier this month publishing insiders buzzed with news that suspense romance writer Kelly Irvin was joining the field. Her forthcoming novel, tentatively called *To Have and to Hold*, will tell the story of a woman whose world is turned upside down when her parents die in a buggy accident–and a suitor returns to, according to an industry announcement, "test her Amish faith and her ability to forgive." The novel is the first in a two-book deal with Harvest House Publishers. Still, the queen of the genre is Beverly Lewis. *The Telling*, the final installment in her *Seasons of Grace* trilogy, made its debut in April and only recently dropped out of the top 20 on various best-seller lists. Lewis' books, set in the Old Order Amish land, have sold some 12 million copies.

Paranormal romance, which continues to enjoy a boost from Stephanie Meyer's *Twilight* series, remains a popular subgenre. Yet vampires, werewolves, and shape-shifters now have competition from knitters, which are part of the "home crafting romance" subgenre–itself part of the "small town" subgenre. Insiders insist that knitting is distinct from another ascendant microgenre: quilting.

The industry would seem challenged to find greater mundanity (bridge games? *Wheel of Fortune* reruns?), yet that's what the public is demanding. "More than ever, people are retreating to the home and simple pleasures of home life," says romance writer Debbie Macomber, who has sold about 75 million books, many centered on knitting, with titles such as *The Shop on Blossom Street*, *Back on Blossom Street*, *Summer on Blossom Street*, and *A Good Yarn*. Macomber recently returned from the Vancouver (B.C.) set of *Call Me Mrs. Miracle*, a Hallmark film based on her work. (It's a sequel to a Hallmark hit, *Debbie Macomber's Mrs. Miracle*, which starred James Van Der Beek, formerly of *Dawson's*

Fans at last year's Romance Writers of America convention in Washington, D.C.



RICHARD A. LIPSKI/THE WASHINGTON POST/GETTY IMAGES

Choose Your Own Steamy Adventure

It's hard to keep up with the rapidly multiplying subgenres of bodice rippers. Here's a guide to some of the latest categories in the $1.4 billion industry that is romance fiction.



Creek.) Macomber even has a successful line of companion books–*Knit Along with Debbie Macomber*–on the joys of the domestic arts.

Another home crafting romance writer, Marie Bostwick, topped *The New York Times*' mass-market fiction list in June 2009 with her novel *A Thread of Truth*. After publishing scores of bodice rippers, Lori Wilde's *The True Love Quilting Club* tells of Trixie Lynn Parks who must, says the book's publisher, choose between fame and fortune or "the one true love who has the power to mend her patchwork heart."

Such substratification might suggest, as one book agent stated privately, that readers have gone insane. However, Harlequin's Orr sees the trends as befitting the times. Amid uncertainty, she says, readers want tight-knit communities they can return to with each new installment of a series. "There is a tremendous desire for community," she says. "Somehow in this world, where everyone is constantly communicating, people have lost real friendships."

Therein may lie the secret to the rise of the romantic subgenre. Twitter feeds, author blogs, and other forms of social media are providing limitless opportunities for virtual Ya-Ya Sisterhoods of like-minded readers to develop. "These authors are all masters of social networking," says Pam Jaffee, the publicist in charge of Avon, HarperCollins' romance imprint. Macomber boasts an e-mail list of 130,000. (By comparison, Jaffee says, most successful authors have "between 3,000 and 9,000 friends" on Facebook.) Bostwick's fans have even formed an online quilting club. This fall, readers from 13 different states will tour her favorite places to quilt.

"I have noticed a new trend …toward Amana," says an author, referring to the remote Amish strain

Devoted fans of Robyn Carr–who hit the jackpot in the military romance niche with her Virgin River series–find each other at the Jack's Bar chat room on her site. "There are so many people out there who have a relative or a loved one who's serving. Those people want to celebrate and honor these men and women. And they want military characters in the books they read," says Carr, a former military wife whose son is serving in Iraq.

The e-bond between authors and fans has had an undeniable impact. A recent blog post on CindyWoodsmall.com alerted readers to a recession-friendly deal from the author's publisher: Three books in her *Sisters of the Quilt* series–a hybrid of the Amish and quilting subgenres–would be available in one volume for $19.99. Woodsmall signed off with the word, *denki*. That's "thank you" in Pennsylvania Dutch. Ⓑ

From 2000 to 2008, the number of American home phones declined by more than 60 million



ILLUSTRATION BY LITTLE FRIENDS OF PRINTMAKING

The Home Phone's Last Gasp

The Web-based Ooma Telo is helping slow the exodus to wireless. *By Arik Hesseldahl*

Ask anyone under 30 for their home phone number and they may look at you funny. The landline business is in permanent decline. After peaking at about 141 million in 2000, the number of U.S. home phones fell to 78 million by the end of 2008, according to the Federal Communications Commission. While most of this erosion was the result of people going wireless, the FCC says some 19 million households replaced landlines with Internet phones.

For the last month I've been testing the latest Internet calling device, Ooma Telo, which offers people who might otherwise go all-wireless the security blanket of a landline-like phone. Recently redesigned and vastly improved from its unimpressive first-generation product, the $250 Telo is essentially a small computer that, when connected to the Internet, works with your existing home phone. For a one-time $40 fee, you transfer your existing home number, enjoy great rates, and eliminate your old phone bill. Think Vonage without the monthly fees.

i

Ooma Telo and Handset

The device ($250) and optional handset ($50) make calls over the Net





Setup was straightforward, starting with creating an Ooma account online. Then I connected the device to my home router. After five minutes, the Ooma was ready for use. I tried it with a Uniden cordless phone, a 1980s-vintage AT&T Trimline, and a wireless Ooma Telo Handset ($50). All sounded good; only two times—throughout more than 20 phone calls—did jarring echoes create an interruption.

Domestic calls are free, with some exceptions: No 900 numbers or phone chat services, and calls to 411 cost 99¢ each. There are also minimal taxes and fees—approximately $3.47 per month for most users. Subscribers also have the choice of upgrading to the Ooma Premier service for $9.99 a month or $119 a year. Unlike Vonage—whose plans range from $9.99 to $35 per month—Ooma's package is optional.

The Premier package has features your rotary phone never dreamed of: You can forward calls to your cell phone, and a Web-based voice-mail system lets you listen to your messages from any browser (or get voice mails by e-mail). International calls require prepaying—calls to France run from 2¢ to 5¢ a minute—and the Ooma works anywhere there's a fast Internet connection, including overseas, so you can take it on the road. Had the old phone companies been this flexible, they might not be watching their business evaporate. **B**

Plunging Into the Swimwear Business

Lynn Werner's staff consists of her two young sons, who help her package online orders



After years of covering up by the pool, a former Disney sales exec decided to get her feet wet

For many women of a certain age, wearing a bathing suit in public is an exercise in strategic camouflage. Such was the plight of Lynn Werner, who ran video-game and software sales for Walt Disney's West Coast region until 2001, when she left to take care of her infant sons. Werner dreaded lounging by the pool. "I was in Maui three years ago, grabbing a towel to cover my legs every time I got up," she recalls. She went to buy a pair of baggy board shorts, but the female offerings were inappropriate for a woman in her 40s. "I kept thinking," she says, "I've got to try to fix this."

Back home in Marin County, Calif., Werner decided to create her own line of board shorts, with mix-and-match bikini and tankini tops for more mature women. She took a course in fashion design at San Francisco's Apparel Arts and contracted a freelance design consultant. While Werner knew her experience in sales could move the product, she admits "I didn't know how to get it made."

It took her almost a year to discover the right microfiber fabric in prints she liked, which she found at a trade show in the South of France. Soon after, her relationship with her pattern-maker fizzled; six months later she moved production to a factory with better equipment. "Now I see what kind of thread you need, the elastic, the lining," she says. "It's crazy how much goes into each piece."

After three years in development, Lynnina Swimwear was launched this June with more than 40 individual pieces–ranging from $49 to $69–all made in Los Angeles. Werner's sales skills have already paid off. After cold-calling from Werner, high-end chain Canyon Beachwear began stocking its shelves with her cougar-chic tankinis.

While Lynnina isn't profitable yet–Werner still underwrites the company's costs herself–business has been strong enough that she's contemplating taking out a line of credit. So far her only employees are her twin sons, who help her package Lynnina's online orders. There are also other, subtler measures of success. "Now," she says, "I don't sit by the side of the pool with a towel around me." B
—*Helaine Olen*

Lynnina's multicolor butterfly halter bikini top, $59



DESIGNING WOMAN

$4.3 bn
Amount that Americans spent on swimwear in 2009

4
Number of swimsuits owned by the average woman in the U.S.

15
Number of freelance consultants used by Werner since 2007

$49-$69
Price range of suit separates in Lynnina's first collection

DATA: LYNNINA, NPD GROUP

PHOTOGRAPHS BY ROBYN TWOMEY FOR BLOOMBERG BUSINESSWEEK

Gallery price:
$4,000

David Benjamin Sherry
How Could I Have Ever Lost You, 2010, traditional color print (30 by 40 inches)



Approx. gallery price:
$4,500



Alisha Kerlin
Solitaire (How to Find Lost Objects), 2010, oil on canvas (29¾ by 48 inches)

Approx. gallery price:
$19,500

Alex Hubbard
Troubadour, 2010, oil, resin, and fiberglass on canvas (96 by 70 inches)



New York's Next Big Things

An investor's guide to the art world's rising stars, now showing at P.S. 1's Greater New York show

There's nothing the art world loves more than the Next Big Thing. That's why the market's top dealers, collectors, and tastemakers are scouring the P.S. 1 Contemporary Art Center's Greater New York show this summer, hoping to find the next Elizabeth Peyton or Cecily Brown—two stars who made their names at the show in 2000.

Held every five years, the exhibition runs through October at the Museum of Modern Art's Queens outpost. It's known for casting a spotlight on rising New York area artists, and past participants have benefited mightily from the exposure—as have discerning dealers and auction houses. When painter Lisa Yuskavage took part in the 2000 show, her works sold for $40,000 to $60,000; seven years later, her portrait of a bosomy femme fatale fetched $1.4 million at Christie's in New York.

This year's 68-artist roster is led by painter Tauba Auerbach, whose abstract canvases resembling folded fabric have caught the eyes of powerful dealers like David Zwirner and Larry Gagosian. "Her work sells before it is finished," says art adviser Lowell Pettit. Her paintings are priced from $16,000 to $40,000, and all her current works are sold out. Their worth is sure to appreciate.

The show's other most promising talents, according to Christie's postwar and contemporary art specialist Alexandre Carel, start with the Bruce High Quality Foundation, an artists' collective that contributed an elegant installation



Zak Prekop
Incomplete Division (Red), 2010, oil on canvas (28 by 24 inches)

Approx. gallery price: $1.800-$3,600



Approx. gallery price: $16,000-$40,000

Tauba Auerbach
Untitled Fold Painting xix, 2010, acrylic on canvas (30 by 40 inches)

Tommy Hartung
The Ascent of Man, 2009, video (color, sound), 15:36 minutes



Approx. gallery price: $5,000-$10,000

of empty podiums. Another headliner is Iranian-born Tala Madani. Known for colorful, cartoonish paintings, Madani earned a Yale MFA in 2006 and has already been purchased by collectors such as Andrew Hall and French billionaire François Pinault. There's a waiting list for her paintings, currently priced at $10,000 to $60,000.

Great things are expected of Brooklyn artist Alex Hubbard, whose labor-intensive resin paintings and video installations impressed tony art adviser Candace Worth. All but one of his pieces, priced from $8,000 to $25,000, have been sold. Video artist Tommy Hartung was considered a lesser-known name coming into the fair, but he has attracted interest on account of *The Ascent of Man*, a video that blends stop-motion animation with film footage to show human evolution from ape to modernity. He is shown at On Stellar Rays, a small New York gallery that's becoming a force itself—four of its seven artists were picked for this year's show.

The art world's inner circle is also closely monitoring David Benjamin Sherry's color-saturated photographs, A.L. Steiner's graphically homoerotic photo collages, and Zak Prekop's abstract canvases, which sell for $1,800 to $3,600. "Prekop is a former art handler who is having a real moment," says Pettit. Alisha Kerlin's solitaire-inspired paintings are also stirring interest; her still-available piece, priced at $4,500, is on hold for a buyer at the shoe-box-sized Y Gallery in New York's East Village. In a few years that might seem like a bargain: Collage artist Wangechi Mutu's pieces sold for a few thousand bucks a pop when she took part in the 2005 show, and three years later one of her large ink-and-collage works was purchased for $406,772 at an auction at Christie's in London. —*Lindsay Pollock*

Invest in



Dealing with A Double-Dip

John Hussman's strategy for playing short-term deflation and long-term inflation

The most emphatic advice I've been giving lately is for investors to carefully consider their investment time horizon. One of the most difficult things I've observed over the last decade is investors very close to retirement—or in need of short-term funds for tuition expenses, down payments on homes, or medical needs—having their plans devastated by extremely deep market declines. If you have near-term financial obligations, you should not be in stocks now.

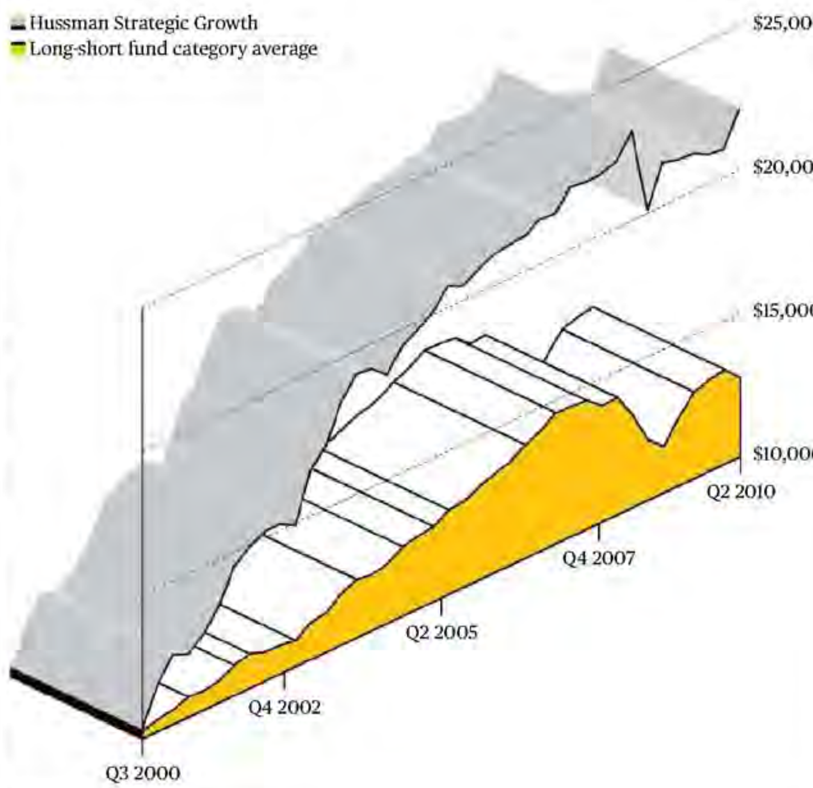
This is because the economy, in my view, is headed for a double-dip recession. The consensus view is that the economy may slow but won't slip. That's largely based on the fact that double dips are rare. The rarity of an event—or the inability to imagine an event—is not evidence. That should be clear from the last couple of years. The consensus of economists has never correctly anticipated a recession.

We are 100 percent hedged in our equity fund [Hussman Strategic Growth]. We would never go net short, so this is as negative as our positioning can get. Since we are worried about deflation in the short-term, our primary concern is revenue and profit-margin stability. We also like dividend yields, which can help reduce the volatility of individual holdings—provided those dividends are well covered by stable earnings. There are companies in the pharmaceutical and consumer staples sectors that have a long history of such stability, even in the face of economic downturns. [As of Mar. 31, Hussman's equity fund owned Colgate-Palmolive and Walgreen, which yield 2.5 percent and 2.4 percent, respectively.]

In our Strategic Total Return fund we've become increasingly wary of long-term Treasury bonds. Now we're mainly in cash, short- and intermediate-term Treasuries, and stable currencies such as the Swiss franc. During periods of credit crises and economic weakness, investors have an almost insatiable appetite for default-free securities. The government is able to issue an enormous quantity of debt without inflationary consequences because individuals are willing to hold it. Over the longer term, though, as the demand for default-free securities subsides, you invariably observe very high and rapid inflation. The government is now currently risking a second great inflation similar to what we observed in the 1970s.

GROWTH OF $10,000

Hussman Strategic Growth has topped its long-short fund category average



DATA: MORNINGSTAR

We are holding Treasuries, but as yields fall, we'll shift into inflation protected bonds

We are holding Treasuries, however as yields fall, we'll shift into inflation-protected bonds. As deflation concerns grow, we are likely to see treasury yields drop [as more people buy Treasuries]. We are also apt to see a fairly strong liquidation of inflation-protected bonds as well as commodities. As the economy weakens, commodities tend to fall, with a lag. Although some investors think of gold as a currency substitute, its correlation with other commodities runs pretty strongly in a downturn. In our Total Return fund we have clipped our precious metals positions. B

—*As told to Lewis Braham*

The Stats: John Hussman is founder of Hussman Funds, a portfolio management company focused on investing for the long term while managing downside risk. The firm manages $8.1 billion. Since its July 2000 inception, the Hussman Strategic Growth Fund has delivered an 8.3 percent annualized return vs. -1.4 percent for the S&P 500.

POLKA DOT IMAGES/AGE FOTOSTOCK

The Summer Cocktail

Famous for great Aviations, the bar at London's Savoy will reopen in October following the hotel's more than $150 million renovation

Talking shop at the local watering hole? Do better than beer

The Want: The go-to order when the boss or a client wants to discuss something after hours. Must be sophisticated and seasonally appropriate. Even better if there's a backstory.

The Get: Try an Aviation, a pre-prohibition standby born in 1916. The tipple regained popularity in the 1930s, during the glamorous days of air travel. The drink is a mix of gin, lemon juice, and maraschino liqueur, which is—mercifully—clear, not cherry red. You'll get a nutty, slightly sweet drink (served up, of course) that keeps you refreshed while you're sweating in your suit. Ⓑ —*Kurt Soller*

OF ALL THE GIN JOINTS IN ALL THE WORLD ...

Four of the world's best airport bars:



One Flew South

Hartsfield-Jackson Airport, Atlanta: This cocktail spot (above) in America's busiest airport is inspired by the prohibition-defying flights of the 1920s.

Piquillo

John F. Kennedy Airport, New York: In Terminal 5, far from the rest of frenzied JFK, it serves tapas, cava cocktails, and white sangria with Cointreau.

Bubbles Seafood & Wine Bar

Schiphol Airport, Amsterdam: Pair champagne with oysters, smoked salmon, or herring at this sleek, modern bar.

Frescobaldi Wine Bars

Leonardo da Vinci Airport, Rome: One of the first enotecas to set up at the terminal, featuring cured meats, cheeses, and 50 Italian wines by the glass.



The Aviation

2 ounces gin
½ ounce freshly squeezed lemon juice
⅓ ounce maraschino liqueur

Shake well with ice, then strain into a chilled martini glass

DRINK: PHOTOGRAPH BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEEK. BAR: GREEN OLIVE MEDIA / GARNISH FOOD PHOTOGRAPHY

There are many ways to enjoy the Web's bounty without turning the medium into a religion



The Sermon On the Monitor

Will Clay Shirky's Web evangelism alienate the browsing masses?

By Paul M. Barrett

Internet missionaries can be terribly annoying. Part of the reason—especially to the print dinosaurs among us—is that they're so correct. Broken old media businesses will change or die. Younger audiences will not just read or watch; they must tweet, blog, and update their status, preferably all at once. More broadly, digital networks are reshaping culture, economics, and politics. That's beyond debate. Like most zealots, however, the Web evangelists often seem self-righteous and oblivious to ambiguity. This trait threatens to limit their appeal even to the already converted.

In his first book, *Here Comes Everybody: The Power of Organizing Without Organizations,* Clay Shirky explained how wikis and flash mobs altered social relations. His new work, *Cognitive Surplus: Creativity and Generosity in a Connected Age,* extends the upbeat argument. By "cognitive surplus," Shirky means potential free time. Right now we're wasting gobs of it on embarrassingly bad television, he writes, and we could do an awful lot of good if we devoted even a few hours apiece to, say, online civic groups. Shirky takes as an example Grobanites for Charity, a far-flung bunch of young women that raises money to help humanity via a website named for their favorite shaggy-chic pop-opera star, Josh Groban. Even if you don't share the Grobanites' taste in music, it's a cool little story about the Internet at its best.

What distinguishes *Cognitive Surplus* from the recent wave of digital-cheerleading books is its ability to show how the medium is well-suited to serving social causes. Shirky, who teaches in the Interactive Telecommunications Program at New York University, tells crisp, memorable parables. As with most parables, his are populated by two-dimensional characters meant to impart simple lessons. Shades of gray are largely absent. We meet plucky teenagers in South Korea who organize online to protest against American beef imports in the wake of mad cow disease. In Kenya a courageous political blogger starts a website that aggregates citizen reports of outbreaks of ethnic violence. Intrepid vacationers click on CouchSurfing.org to find volun-

Cognitive Surplus: Creativity and Generosity in a Connected Age
By Clay Shirky
THE PENGUIN PRESS, 242 pp, $25.95



ILLUSTRATION BY MATT OWENS/VOLUMEONE

teer hosts, while PickupPal.com matches carpoolers more efficiently than was possible by phone. The anecdotes lift the spirit, even for a reader who wouldn't dream of traveling across Europe based on digital reservations for crashing on the couches of complete strangers.

By the middle of this slim volume, however, one notices a certain sameness in the creativity and generosity Shirky heralds. Everyone online seems inoffensive and vaguely progressive. From this sampling, Shirky draws odd generalizations. "Because the social tools we now have can shape public speech and civic action," he writes, "people who design and use them have joined the experimental wing of political philosophy." When did carpooling, admirable as it may be, become a branch of political philosophy?

A lot of people who design and use newfangled social tools are pretty conventional in their thinking—and their opinions don't all point in one direction. Pro-gun, anti-gun. Pro-choice, anti-abortion. Balance the budget, stimulate the economy. They're all out there online, soliciting contributions, hyperlinking, selling ads, and arguing their briefs. It often seems more like a wearisome cognitive overload than an invigorating cognitive surplus.

The Internet, through its very nature, amplifies all ideas, good and bad. It's just as useful to al Qaeda and child-porn merchants as it is to healthy-beef activists. It's a mixed bag, not an unmitigated blessing. While the Web may empower people to do good in previously unimaginable ways, one can still appreciate new forms of networked munificence without turning digital communication into a religion.

Shirky acknowledges that a lot of people distract themselves with silly cat-photo sites—ICanHasCheezburger.com and the like—but he suggests misleadingly that that's as low as the online world goes. He also gives short shrift to the Internet as mundane convenience. For a lot of us, the ease of ordering books or Chinese food online plays just as large a role in the digital revolution as making charitable contributions by click rather than snail mail.

Shirky commits other distortions, too. Television, in his rendering, is all *Gilligan's Island* and *The Partridge Family*. Agreed: Most TV programs are a waste of time, and the world might be a better place if more people eschewed *Jersey Shore* for Grobanites for Charity. Still, some of us occasionally want to escape into a good story or spend time in the company of a diverting ensemble of neurotics. What's wrong with that? So far, the Internet doesn't generate much original entertainment of any heft—at least none that Shirky notes. He ought to check out *The Daily Show, American Masters, Curb Your Enthusiasm,* or *30 Rock*. He might even benefit from a hearty laugh or two. Same story on public affairs: There is nothing online to rival *60 Minutes* or many of the documentaries on HBO. In fact, we might be better off as a society if more people watched these programs.

Like many of the high-tech faithful, Shirky displays a casual disdain for print. Publishing, he notes, was once something only publishers could do. "Publishing had to be taken seriously when its cost and effort made people take it seriously," he writes. "An activity that once seemed inherently valuable turned out to be only accidentally valuable."

This short review isn't the place for a full-dress defense of newspapers, magazines, and books. Suffice it to say, there are still many millions of readers who derive value from those products, even if the profit-and-loss formulas are shifting. Shirky doesn't explain how the do-it-yourself chaos of the Internet will produce a melancholy Richard Ford novel or Michael Lewis' next dissection of American business—or, for that matter, Clay Shirky's next book-length sermon on the Internet. ❸

The Internet amplifies all ideas, good and bad. It's as useful to al Qaeda and child-porn sellers as to charities

Web Surfing for The Soul

The Internet offers nearly limitless potential for our cognitive surplus, or free time. Here are some sites that author Clay Shirky suggests are worth a diversionary visit—or are at least better than watching *Jersey Shore*.


Fans of pop singer Josh Groban raise money for underfunded charities
Grobanitesforcharity.org


Admirers of DBSK used the Korean boy band's site to protest imports of American beef
dbskexclusive.net


Lenders who want to finance entrepreneurs across the globe to fight poverty
Kiva.org


Citizens interested in promoting a green lifestyle, in addition to human rights concerns
Care2.com


African activists who track political violence in Kenya, Congo, and elsewhere
Ushahidi.com


NGO activists and supporters looking to team up with like-minded neighbors
NetSquared.org


Residents offering a night's stay to complete strangers, including intrepid travelers
CouchSurfing.org


Philanthropy-minded individuals looking to help students in need
DonorsChoose.org


Commuters dedicated to the improvement of the carpooling system
PickupPal.com


A project of Action Without Borders that connects volunteers with organizations
idealist.org

ICONS BY L-DOPA

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FSC Mixed Sources

Larry King

"At 6 a.m., I get a phone call from Ted Turner. ... 'I hear you want to leave,' Ted says to me. 'Say it to my face'"

As *Larry King Live* nears its end, the show's iconic host remembers how he nearly walked away from CNN decades ago



It was 1989, and I had been doing *Larry King Live* for about four years. My contract with CNN was up, and I had three months to look around. My agent, the late Bob Woolf, got a lot of substantial offers for me to consider.

Fox wanted me. ABC said they wanted to put me on behind Ted Koppel. The King brothers [of King World Productions] wanted to give me a deal similar to the one they had given Oprah. The show would be syndicated and I would get 9 percent of the profits.

I was making $800,000 at the time and the deals would have paid me $1.5 million. It should have been a no-brainer. I decided to take one of them, and I told Bob to get it done. It was a good time to take the chance. My show was doing well, and it was a lot of money.

I remember getting picked up that night at LAX. I was dating Angie Dickinson at the time, and we were going to dinner at the Beverly Hills Hotel. The next morning, at 6 a.m., I get a phone call from Ted Turner in New York. He's got Bob Woolf in his office and they're on speakerphone.

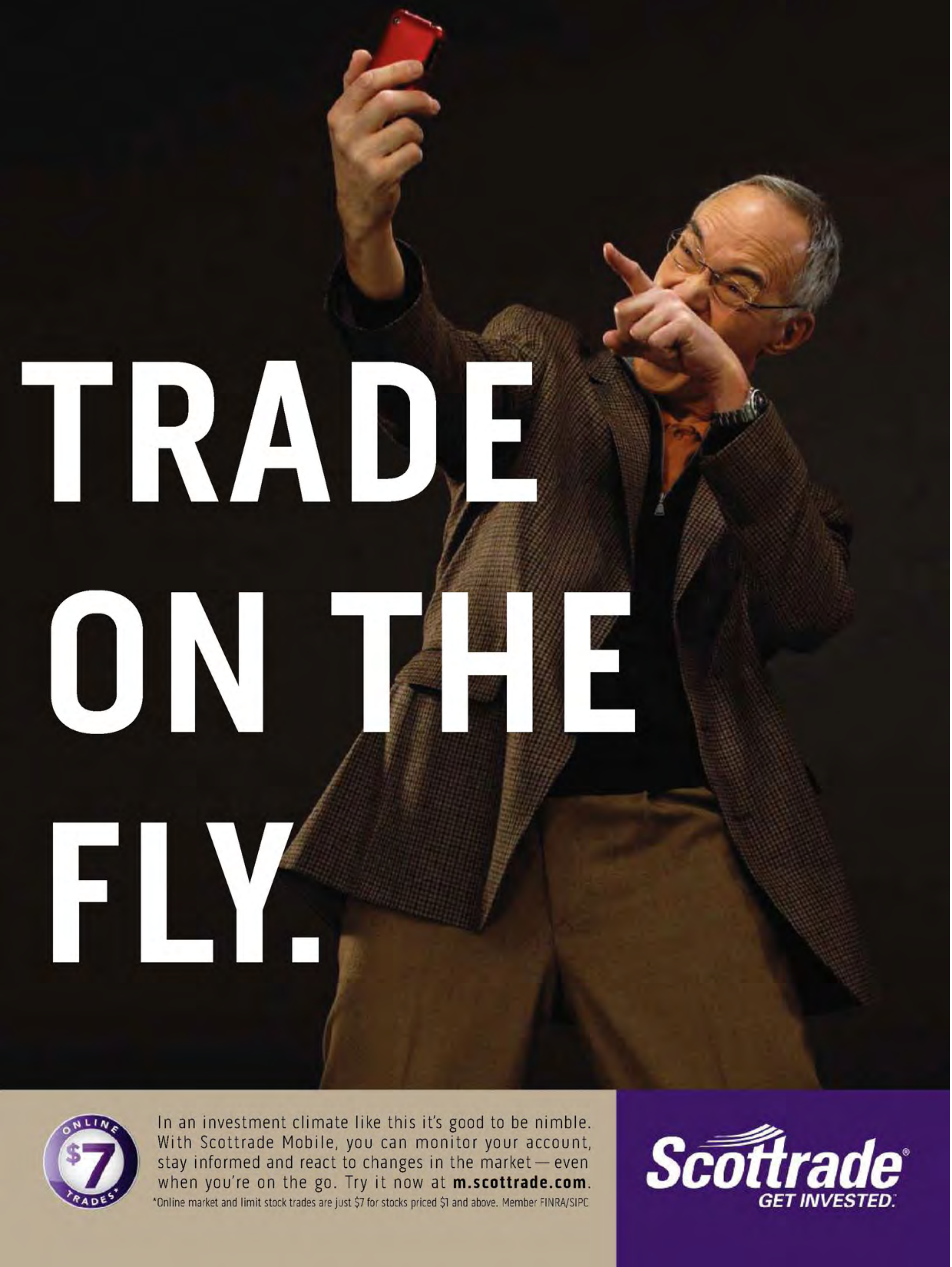
"I hear you want to leave," Ted says to me. "Say it to my face." I hear Bob behind him saying, "That's unethical." But Ted says, "Screw the ethics. Tell me goodbye to my face."

That's when I remembered discussing it with Angie the night before. She had asked me, "Are you unhappy, is that why you're leaving?" I wasn't. She said, "If you take all that money, the moment you're unhappy you're going to say to yourself, 'Why the heck did I make the change?'"

She was right. I told Ted I was going to stay. Our show started to take off, and pretty soon I was making a lot more money. It turned out to be the right decision. Sometimes you don't need to make a change to succeed. Sometimes success is right in front of you.

Later on, I was at The Palm restaurant in Washington. Michael King was sitting across the room from me. He stands up and shouts, "I made you big money!" —*As told to Ronald Grover*

DAVID JOHNSON/CORBIS OUTLINE


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